PhD Dissertation in Law

Title: **Beyond the 'One-Size-Fits-All' Model: Reassessing Securities Litigation Reform Through Comparative Institutional Complementarity**

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Declaration

I, [Chengxiao Jiang] confirm that the work presented in my thesis is my own. Where information has been derived from other sources, I confirm that this has been indicated in the thesis.

Abstract

This study presents an integrated framework for comparing securities litigation systems by combining three perspectives: conventional comparative analysis of formal rules, a revised functionalist view assessing institutional effectiveness (Functional Magnitude), and the principle of institutional complementarity from comparative economics. Applying it to the U.S., U.K., and China reveals the deeper logic behind their institutional differences.

In the U.S., recent enforcement data explains why an active class action system has taken root. The U.S. experience shows that reform must stay flexible and responsive to market conditions. In retail-driven, highly liquid and large-volume markets, overreliance on public enforcement is risky. Thus, private enforcement should be strengthened. In the U.K., the high threshold for private enforcement in FSMA 2000 and common law, combined with the Financial Conduct Authority's cautious approach to investor compensation, support a conservative litigation model. This suggests that securities litigation reform should focus on incremental adjustments to existing frameworks rather than pursuing sweeping or disruptive changes. In China, an analysis of the securities enforcement system during 2019 Securities Law reform reveals that the combination of a unitary liability framework and the Special Representative Litigation (SRL) is not coincidental, but rather a natural product of the country's institutional environment. This argues that effective reform must align with the state's institutional DNA, and legal transplants must be adapted to local political, economic, and cultural contexts.

Based on these insights, the study proposes a three-step approach to understanding the role of securities litigation and considering any reform: (1) Reform should treat securities litigation laws as part of a dynamic governance system by assessing their compatibility with local institutions; (2) Reform should align legal design with the market's development stage—public enforcement is key in emerging markets, while mature markets benefit from a coordinated mix of resource-efficient public oversight and enhanced private enforcement; (3) Reform should focus on improving existing systems through functional upgrades and better integration, rather than creating excessive new regulations that risk inefficiency and market disruption.

Impact Statement

This study builds an original comparative law framework based on the concept of institutional complementarity to analyse the core differences and underlying logic shaping securities litigation systems in the U.S., U.K., and China. It challenges the traditional pursuit of a single “optimal design.” The study’s theoretical innovation and practical insights will shape the understanding of securities litigation as an investor protection mechanism, its importance in global securities regulation and any reform, and cross-border regulatory coordination in the following ways:

1. An Original Approach to Comparative Analysis：Comparative Institutional Complementarity

The study introduces an original analytical method combining three approaches: (1) Conventional analysis of formal legal institutions; (2) A Modified functionalist (including Functional Magnitude) perspective on the efficiency of legal institutions; (3) The principle of institutional complementarity found in the paradigms of comparative economics and comparative institutional economics. This combined comparative analysis, when applied to the divergent securities litigation regimes in the U.S., U.K. and China, is better able to capture more nuanced insights.

2. Practical Lessons from Three Countries

United States: This study demonstrates a significant correlation between market scale and optimal securities enforcement mechanisms. The U.S. market's distinctive characteristics—particularly its massive size—make private enforcement prioritisation the most effective reform approach. Given the SEC's operational constraints in efficiently compensating investors at scale, private class actions become indispensable.

United Kingdom: The U.K. relies on strong ex-ante regulation and market self-discipline, such as FCA enforcement and the Stewardship Code, shifting investor protection from lawsuits to dialogue between issuers and institutional investors. This study shows that the existing weak private enforcement here reflects institutional complementarity rather than failure. Any securities litigation reform must balance institutional deterrence and market competitiveness.

China: The *Kangmei* case demonstrates the potential of China's Special Representative Litigation (SRL) for investor compensation. This study reveals that the SRL reform represents an administrative-led model that strategically activates private enforcement capacities, rather than adopting a U.S. class action. The findings underscore how securities litigation reform must be carefully calibrated to align with a state's unique political economy, developmental stage, and legal-cultural context.

3. A Strategic Roadmap for Effective Legislative Reform

Reforms in securities litigation, if any, should follow a three-step approach. Firstly, they must decode local institutional DNA—any effective reform must reflect a country's unique institutional traits, as blindly copying foreign models often leads to failure. Second, reforms should match the market's development stage: emerging markets should rely on public enforcement to establish compliance norms; growing markets can introduce limited private litigation with appropriate safeguards; and mature markets should develop coordinated public-private enforcement mechanisms. Thirdly, instead of creating entirely new systems, reforms should focus on optimising existing institutions, emphasising functional improvements over structural redesign.

4. A Normative Conclusion

This study marks a fundamental shift in rethinking securities litigation, challenging conventional approaches to legal transplants. It demonstrates that even the U.S. model—often viewed as the global benchmark—exhibits inherent enforcement limitations and context-specific institutional logic that preclude its universal template. The regulatory approaches adopted by both the U.K. and China substantiate this finding: when confronting critical gaps in their securities markets, these jurisdictions have deliberately eschewed formulaic solutions in favour of tailored frameworks that reflect their distinct institutional ecosystems. These findings collectively suggest an original framework for thinking about securities litigation and potential reform—one that moves beyond the illusion of an "optimal design." Instead, regulators should decode institutional DNA, align reforms with market stages, and strengthen existing systems. Genuine reform means letting laws evolve through complementarity, not forced transplantation.

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Chapter I

Institutional Complementarity in Global Securities Litigation: Research Background and Methodological Basis

1. Divergent Pathways in Securities Litigation: A Global Institutional Landscape

The globalisation of capital markets has intensified the need for robust legal frameworks to protect investors. As cross-border investments grow, regulators worldwide face the challenge of balancing market liberalisation with safeguards against fraud and systemic risks, whether from solvency crises in interconnected institutions or contagion driven by collapsing market confidence.[1] Central to this balance is securities litigation, a legal mechanism designed to deter misconduct, compensate victims, and uphold market integrity.[2] There are ongoing discussions regarding the best way to structure such litigation,[3] despite the fact that its theoretical significance is generally

[1] Martin Gelter, 'Global Securities Litigation and Enforcement' in Pierre-Henri Conac and Martin Gelter (eds), *Global Securities Litigation and Enforcement* (CUP 2019) 3, 4-7.

[2] RA Posner, 'Law and the Theory of Finance: Some Intersections' (1986) 54(2) Geo Wash L Rev 159, 160-169.

[3] R La Porta et al., 'What Works in Securities Laws?' (2006) 61(1) J Finance 1, 27-28.

accepted. Different models are adopted by different jurisdictions, which raises important questions about which features benefit markets, investors, and larger economic objectives.[4]

1.1 Research Background and Introduction to the Comparative Study for the U.S., U.K., and China

Financial scandals, stock market collapses, and speculative bubbles—from the 2008 crisis to recent volatility in markets—highlight inherent vulnerabilities in capital markets. Investors increasingly diversify across jurisdictions, and disparities in legal protections also create uneven risk exposure. For regulators, one question would be whether there is an optimal securities enforcement framework, particularly in designing mechanism for private securities litigation, as a strategic necessity to attract global and domestic capital and maintain investor confidence.

In theory, economics establishes that the operation of securities markets necessitates legal intervention.[5] Admittedly, the Efficient Capital Market Hypothesis (ECMH) envisions securities markets as frictionless systems where the price and its fluctuation reflect the authentic value of the goods, guided by perfect competition, transparency, and rational market

[4] John C Coffee, 'Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance' (2002) 102(7) CLR 1757, 1811-1828.

[5] Paul A Samuelson and William D Nordhaus, *Economics* (19th edn, McGraw-Hill 2010) 160.

participants.[6] However, real-world markets deviate due to structural flaws:[7] studies have pointed out that information asymmetry, behavioural biases, and negative externalities exist d in markets.

In practice, securities, as credence goods, are difficult to fully evaluate before purchase and often not even afterward. [8] Therefore, if investors cannot make a sufficient evaluation before purchase, it would create a "lemons problem" where high-quality assets exit markets due to investor scepticism, leaving riskier ones and destabilising markets according to the theory of information asymmetry.[9] Moreover, behavioural economics reveals irrational investor tendencies (investment biases)—loss aversion, overconfidence, herding, and mental accounting—that fuel volatility, bubbles, and suboptimal decisions.[10] Furthermore, negative externalities arise when individual risks (e.g., hedge fund speculation) cascade through interconnected institutions, threatening market stability,[11] and the existence of transaction costs hinders

[6] Eg E F Fama, 'The Behaviour of Stock-Market Prices' (1965) 38(1) J Bus 34, 44.

[7] Robert B Cooter and Thomas Ulen, *Law and Economics* (6th edn, Prentice Hall 2011) 32; 'Efficient Markets, Random Walks, and Bubbles' in Robert J Shiller, *Irrational Exuberance* (2nd edn, Princeton University Press 2005) 177-194.

[8] B G Malkiel, 'The Efficient Market Hypothesis and Its Critics' (2003) 17(1) J Econ Perspect 59, 60.

[9] G A Akerlof, 'The Market for "Lemons": Quality Uncertainty and the Market Mechanism' (1970) 84(3) Q J Econ 488, 500.

[10] C Jolls et al., 'A Behavioral Approach to Law and Economics' (1998) 50(5) Stan L Rev 1471, 1545; C R Sunstein, 'Behavioral Analysis of Law' (1997) 64(4) U Chi L Rev 1175, 1179; A Tversky and D J Koehler, 'Support Theory: A Nonextensional Representation of Subjective Probability' (1994) 101(4) Psychological Review 547, 548; M Kelman et al., 'Context-Dependence in Legal Decision Making' (1996) 25(2) J Legal Stud 287, 288-298; N D Weinstein, 'Optimistic Biases about Personal Risks' (1989) 246(4935) Science 1232, 1233; C Camerer, 'Individual Decision Making' in J Kagel and A Roth (eds), *The Handbook of Experimental Economics* (Princeton University Press 2020) 587-704.

[11] J-K Kang and R M Stulz, 'Do Banking Shocks Affect Borrowing Firm Performance? An Analysis of the Japanese Experience' (2000) 73(1) J Bus 1, 12.

private solutions to these risks.[12] Overall, these weaknesses, which stem from human fallibility and institutional flaws, necessitate regulatory action to improve transparency, match incentives with the interests of society, and incorporate behavioural correction. That is, an effective regulatory framework can balance market freedom with safeguards, steering capital toward productive growth and mitigates speculative collapses.

In terms of institutional design, legal intervention typically materialises through securities regulation employing dual enforcement mechanisms—public and private—to address market failures rooted in information asymmetry, behavioural biases, and systemic risks.

Central to this "dual" framework is mandatory disclosure,[13] which mandates entities, mostly issuers, to provide standardised, material information to investors, deterring fraud, balancing insider-outsider knowledge gaps, and enhancing price accuracy.[14] This is because issuers' informational advantage persists, enabling exploitation,[15] while behavioural biases like herding or panic selling distort decisions.[16] Therefore, the

[12] A C Pigou, 'Chapter IX: Divergences Between Marginal Social Net Product and Marginal Private Net Product' in *The Economics of Welfare* (4th edn, Macmillan 1932) 172.

[13] C Jordan, *International Capital Markets: Law and Institutions* (2nd edn, Oxford University Press 2021) 71.

[14] C J Meier-Schatz, 'Objectives of Financial Disclosure Regulation' (1986) 8(3) J Comp Bus & Cap Market L 219, 227.

[15] D P Morgan, 'Rating Banks: Risk and Uncertainty in an Opaque Industry' (2002) 92(4) Am Econ Rev 874, 887.

[16] C Honigsberg, R Jackson and Y Forester Wong, 'Mandatory Disclosure and Individual Investors: Evidence from the JOBS Act' (2016) 93 Wash U L Rev 293, 297-302.

mandatory disclosure could be partially mitigated through standardised disclosures that reduce information asymmetry. For example, public enforcement,[17] led by agencies like the U.S. Securities and Exchange Commission (SEC), prioritises information disclosure through penalties,[18] deterrence, systemic oversight, as well as prosecutions.[19] Similar roles are performed by the Financial Conduct Authority (FCA) in the UK and the China Securities Regulatory Commission (CSRC) in China.[20]

Additionally, dual enforcement mechanisms are not mutually exclusive choices; rather, they function in a complementary manner. This is because resource disparities and regulatory capture risks hinder effectiveness,[21] necessitating private enforcement, which empowers investors to seek redress, fills enforcement gaps, and further deters misconduct. The evolution of dual enforcement thus naturally arises from these complementary dynamics.

In practice, the U.S. invented the class action model, which permits collective investor claims without prior individual consent (opt-out).

[17] John Armour et al, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, OUP 2017) 40.

[18] John C Coffee Jr, ‘Law and the Market: The Impact of Enforcement’ (2007) 156 U Pa L Rev 229, 255.

[19] Tebsy Paul, ‘Friends with Benefits: Analyzing the Implications of United States v Newman for the Future of Insider Trading’ (2016) 5 Am U Bus L Rev 109, 125.

[20] Hui Huang, ‘China: Private Securities Litigation: Law and Practice’ in Pierre-Henri Conac and Martin Gelter (eds) (2019), note 1, 879, 881.

[21] Eg Legislators are captured by the lobbying industry, while regulatory agencies may be influenced the industry by the latter’s persuasion and the revolving door syndrome. Richard Marcus, ‘“American Exceptionalism” in Goals for Civil Litigation’ in Alan Uzelac (ed), *Goals of Civil Justice and Civil Procedure in Contemporary Judicial Systems* (Springer 2014) 123, 129. <https://ssrn.com/abstract=2427945> accessed 3 May 2025.

However, some argue that it deters corporate violations by threatening expensive litigation. [22] In contrast, while it seems like the U.K. relies heavily on public enforcement by regulators like the FCA, the framework for private securities enforcement is grounded in common law and the FSMA 2000. However, historically restrictive procedural rules, such as stricter certification requirements and prohibitions on contingency fees, have limited its effectiveness.[23] Therefore, since private securities litigation remains rare, the U.K.'s ex-post investor protections appear robust on legal texts.[24] Meanwhile, a unique experiment is provided by China's quickly changing securities market. Introduced in the 2019 revision of the Securities Law, its Special Representative Litigation (SRL) system (an opt-out collective action) combines state-led enforcement with similar U.S.-style class action model, enabling state-backed entities to bring lawsuits on behalf of investors.[25]

These divergent models expose unresolved conceptual and practical challenges in thinking about securities litigation frameworks. The fundamental one is whether there is an optimal design for enabling private securities litigation to support attractive and successful capital markets. Further, as the U.S. boasts the largest capital markets globally, [26] three

[22] See Chapter II Section 3.2.
[23] See Chapter III Section 3.3.
[24] See Chapter III Section 2.5.
[25] See Chapter IV Section 3.2.
[26] <https://data.worldbank.org/indicator/CM.MKT.LCAP.CD?locations=US> accessed 3 May 2025.

interlocking questions arise: Firstly, is the U.S. opt-out class action an indispensable component of modern securities litigation or merely one culturally or politically contingent approach among many? Second, does a "bottom-up" litigation-driven model—premised on active investor participation—constitute a logical foundation for regime design, or does it inherently favour markets only with mature shareholder activism cultures? Thirdly, even assuming the U.S. model serves as a reliable reference, how should jurisdictions, drawing the lesson from the U.S., calibrate the equilibrium between public and private enforcement, given the variety of enforcement tools and cultures existing in different jurisdictions?

As we will see further in this study, securities litigation emerges where legal frameworks, economic policies, and regulatory oversight intersect. This study investigates the role of securities litigation across three jurisdictions to determine whether a "single optimal model" exists and, if not, how each jurisdiction's model serves its purpose and provides the balance needed in trade-offs between deterrence, fairness, and practicality.

1.2 Methodological Foundations for US-UK-China Comparative Analysis

Securities litigation has evolved from a procedural last resort for harmed investors to a vital component of financial regulation. Its purpose is to address systemic market failures that stem from information asymmetry and other factors. Although markets are supposed to self-correct through the "invisible hand," in practice, information asymmetry, negative externalities, and irrational behaviour often require regulatory intervention.[27]

In practice, legislators worldwide recognise six cardinal objectives: protecting vulnerable retail investors, ensuring financial stability, optimising market efficiency, maintaining competitive fairness, preventing financial crimes, and upholding substantive justice.[28] These goals coalesce around a fundamental premise: financial instruments, unlike physical commodities, derive value from intangible informational attributes. Stocks, bonds, and derivatives function as informational commodities whose prices reflect aggregated data about issuers' performance and prospects.[29] However, as we have discussed in Section 1.1, markets cannot autonomously verify or standardise this information, creating fertile ground for misrepresentation.[30] As a legal intervention, securities litigation thus emerges as both sword and

[27] John C Coffee, 'Market Failure and the Economic Case for a Mandatory Disclosure System' (1984) 70(4) Va L Rev 717, 725; Merritt B Fox, 'Rethinking Disclosure Liability in the Modern Era' (1997) 75(2) Wash U L Q 903, 908.

[28] Eg IOSCO Board, *Evolution in the Operation, Governance and Business Models of Exchanges: Regulatory Implications and Good Practices* (Final Report FR/09/2024, November 2024) <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD779.pdf> accessed 5 May 2025.

[29] G Galati and R Moessner, 'Macroprudential Policy: A Literature Review' (2013) 27(5) J Econ Surv 846, 858; Ray Ball, 'The Theory of Stock Market Efficiency: Accomplishments and Limitations' (1996) 22 J Finance Educ 1, 8.

[30] Dan Awrey, 'The Mechanisms of Derivatives Market Efficiency' (2016) 91(5) NYU L Rev 1104, 1138.

shield—a mechanism to penalise misrepresentation wrongdoers while compensating harmed investors, thereby restoring market integrity.

That is, securities litigation rests on two main functions: deterrence and compensation.[31] Firstly, litigation creates monetary or punitive consequences against misconduct by imposing liabilities on violators, which deters future violations. Second, compensation mechanisms maintain faith in the fairness of the market by redistributing losses from violators to harmed investors. In the end, with two functions, litigation improves market efficiency and protect investors. This is supported by empirical research in the "law and finance," which demonstrates that countries with strong securities litigation frameworks typically create deeper, more liquid capital markets.[32]

However, the design of these frameworks remains widely debated, as evidenced by divergent approaches in the U.S., U.K., and China—each reflecting unique legal philosophies, market structures, and cultural attitudes toward litigation. Specifically, three different but globally significant economic models of capital market success are embodied by the U.S., U.K., and China's securities markets, and each reflects a unique institutional framework that merits a comparison:

[31] A Hellgardt, 'Comparing Apples and Oranges? Public, Private, Tax, and Criminal Law in Financial Markets Regulation' in W-G Ringe and P Huber (eds), *Legal Challenges in the Global Financial Crisis* (Hart Publishing 2014) 157-169; J Goldberg and B Zipursky, 'The Fraud-on-the-Market Tort' (2013) 66 Vand L Rev 1755, 1760.

[32] R La Porta et al. (2006), note 3, 27-28.

Firstly, the U.S. market—the largest and most liquid in the world, led by the New York Stock Exchange and NASDAQ—shows the effectiveness of both strict SEC oversight and its well-known class action model.[33] Second, the 300-year-old London Stock Exchange, which still hosts global companies, is an excellent representation of the U.K. market, which is one of Europe's most prominent and significant financial hubs. Its regulator, the FCA, has transformed the securities regulatory framework from self-regulation in the 1980s to a system harmonised with EU Directives, and has since adopted more flexible forms of governance under its post-Brexit reform agenda. Specifically, the FCA's principles-based oversight combined with modernised private litigation mechanisms (led by FSMA 2000), sustains the London Stock Exchange's global competitiveness and market integrity.[34] Thirdly, China's rapidly expanding markets in Shanghai and Shenzhen illustrate a state-guided evolution marked by significant reforms including registration-based IPOs and the pioneering SRL.[35] Together, these leading economies outline three different routes to operate an effective securities market: the U.S.'s emphasis on litigation-backed transparency, the U.K.'s focus on regulatory flexibility, and China's combination of state stewardship and market liberalisation. Their continued global prominence, despite

[33] See Chapter II Section 4.3.
[34] See Chapter III Section 4.4.
[35] See Chapter IV Section 1.1.

institutionally divergent approaches, offers an important methodological foundation for the selection of jurisdictions in this study.

Apart from the choice of jurisdiction, the methodological approach in this study deliberately diverges from the quantitative empirical approach dominant in law and finance (L&F) scholarship, which seeks universal "optimal" rules by scoring legal institutions against market performance metrics. While such empirical approaches illuminate correlations between liability standards and capital market depth, they risk oversimplifying complex realities by treating legal systems as if they were separable from the broader institutions they are part of.[36]

This study proposes that the distinct institutional characteristics of these three representative jurisdictions suggest that securities litigation frameworks are not one-size-fits-all tools—they are shaped by each society's history, legal enforcement structure, and other factors.[37] Therefore, rather than chasing after a so-called "winning formula," a comparative understanding grounded in institutional complementarity better accommodates this complexity.[38] That is, by centring how divergent institutional logics—shaped by distinct legal traditions and sociopolitical contexts—resolve shared regulatory challenges, this approach prioritises the adaptive potential of legal transplants over rigid

[36] See Chapter I Section 3.
[37] See Chapter I Section 2.
[38] See Chapter I Section 2.

doctrinal universalism, emphasising pragmatic solutions aligned with institutional realities rather than theoretical ideals.

The distinct institutional characteristics of these three securities litigation frameworks are briefly outlined below and will be elaborated in Chapters II–IV. As an outline, the U.S. model, known for its opt-out class action system, revolutionised securities litigation through procedural innovations like the fraud-on-the-market theory.[39] By constructing a presumption of reliance for plaintiffs, this framework extremely lowers the plaintiffs' burden of proof and thereby ultimately is favourable to the granting of certification enabling mass claims against disclosure violations.[40] However, the model's flaws have become increasingly apparent. Here, "strike suits" filed against companies after their stock drops often bring little money back to investors but earn large fees for lawyers.[41] Reforms like *the Private Securities Litigation Reform Act* (PSLRA) and judicial retreats from expansively recognising liability (e.g. *Morrison* and *Halliburton*) further reflect growing scepticism about its shortcomings.[42] Thus, amid such conflicting dynamics, the resilience of U.S. securities markets necessitates evaluating how its investor-led litigious mechanisms function, particularly their effectiveness in handling mass claims.

[39] See Chapter II Section 3.2.

[40] Ibid.

[41] See Chapter II Section 1.1.

[42] *Morrison v National Australia Bank* 130 S Ct 2869 (2010); *Halliburton v Erica P. John Fund, Inc* (2014) 134 S Ct 2398.

In contrast, while the U.K. approach prioritises public enforcement through agencies like the FCA, private litigation plays a peripheral role.[43] Here, private litigation is constrained by cost rules and cultural aversion to litigation (gentlemanly capitalism), and thus British securities lawsuits remain rare despite having a fine theoretical statutory framework for investor protection in the legal context.[44] The 2014 Tesco accounting scandal exposed serious problems: although regulators set up a compensation scheme, some harmed investors received nothing. Also, because of legal precedents and the complex custodial chain of shareholders, many struggled to get compensation through private litigation.[45] Meanwhile, recent reforms like Collective Proceeding Order signal cautious steps toward hybrid enforcement.[46] Taken together, the U.K. model and its route to reform may provide a cautionary tale—illustrating the risks of overreliance on regulatory paternalism.[47] However, its emphasis on procedural rigour and compliance cost control, such as frivolous lawsuits, offers legitimate lessons for jurisdictions seeking to curb the abuse of private litigation. It is also worth observing how post-Brexit Britain adjusts the recalibration between public and private

[43] See Chapter III Section 4.1.
[44] See Chapter III Section 4.4.
[45] *SL Claimants v Tesco Plc* [2019] EWHC 2858 (Ch).
[46] See Chapter III Section 3.2.
[47] See Chapter III Section 4.4.

enforcement, which may serve as a real-time experiment in balancing market discipline with investor protection.

The Securities Law (2019) established China's SRL, a state-led alternative that combines U.S.-style class action with Chinese socialist legal philosophy. Here, the state-backed public agency, the China Securities Investor Services Centre, uses an opt-out regime to litigate on behalf of harmed investors, which shows how the potential of SRL overcomes traditional requirements for individual plaintiff participation. By cutting litigation costs and simplifying procedural requirements, the SRL has democratised access to justice for China's millions of retail investors. Early precedent appears promising: over 50,000 investors recovered losses in the *Kangmei*, a feat unimaginable under China's previous reliance on regulator-led enforcement. [48] Thus, China's model holds particular relevance for emerging economies that seek to gradually bolster investor confidence without fully and promptly relinquishing state-led control. To some extent, it demonstrates how centralised oversight can amplify private enforcement's reach while exposing well-tension between market credibility and strict government control.

[48] Ibid.

Possibly, the optimal design of securities litigation lies in adaptive hybridity. Jurisdictions may craft bespoke solutions that balance public and private enforcement based on political economy, legal culture, and even market maturity. For the U.S., this may mean stricter gatekeeping against frivolous suits while preserving collective redress (class action) for systemic frauds. Extending litigation funding mechanisms could improve private enforcement in the U.K. without going overboard like in the U.S. model. Gradually depoliticising SRL procedures could increase its effectiveness and China's reputation abroad. The U.S., U.K., and China's models will continue to be vital points of reference in this changing environment—not as models to be copied, but as compass points that direct the pursuit of just, effective, and culturally relevant solutions.

2. Institutional Complementarity within Comparative Approaches: A Three-Dimensional Analytical Framework

This study examines the reconstruction of securities litigation through a comparative legal analysis grounded in the analytical lens of institutional complementarity. In addition to this framework, the methodology combines two comparative approaches: (1) a contextualised comparison of formal legal institutions, and (2) a functionalist perspective that incorporates for functional magnitude.

Further, the methodology draws insights from the research methods of comparative institutional economics, and its framework systematically analyses three dimensions of securities litigation regimes in the U.S., U.K., and China:

(a) *Institutional Interdependence* (the logical starting point of institutional reform): Mapping how formal legal structures interact with informal norms and enforcement practices in each jurisdiction;

(b) *Functional Magnitude* (the scale of institutions that reforms must address): Assessing how the economic needs of markets shape institutional design;

(c) *Path Dependence and its Institutional Complementarities* (the adjustment of new institutions based on existing ones): Tracing how historical institutional trajectories influence the adaptability of reform proposals.

By integrating these perspectives, the study aims to produce a holistic understanding of securities litigation design—addressing (1) where to initiate reforms, (2) the scope of institutional change required, and (3) how to align new institutions with existing frameworks. It acknowledges the complexity of transplanting institutional models and identifying context-sensitive principles for reform. The following discussion will systematically explain the theoretical foundations and appropriateness of each dimension within this analytical framework.

2.1 Legal Transplants and Informal Institutions Constraints

In the institutional evolution of modern societies, legal reform is often regarded as a pivotal instrument for driving economic development and social governance. Further, legal reforms do not succeed on their own, but they fundamentally depend on their compatibility with informal institutions such as cultural contexts, political systems, and ideological frameworks.

Traditional Comparative Economic Systems (CES) research has long cautioned that institutions constitute complex networks of historical, cultural, and political interconnections. [49] This inherent risk stems from the institutional complementarity between legal systems and economic institutions/social norms as informal regulatory frameworks.[50]

The shaping of institutional systems remains deeply embedded within the political architecture and ideological soil.

[49] Eg S Rosefielde, *Comparative Economic Systems: Culture, Wealth, and Power in the 21st Century* (John Wiley & Sons 2002) 45-53; Peter A Hall and David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (OUP 2001) 1-70; Bruno Dallago and Sara Casagrande (eds), *The Routledge Handbook of Comparative Economic Systems* (Routledge 2023) 811-847.

[50] Peter A Hall and Daniel W Gingerich, 'Varieties of Capitalism and Institutional Complementarities in the Political Economy: An Empirical Analysis' (2009) 39(3) Brit J Pol Sci 449, 464.

The study shows that similar capitalist institutions may evolve distinct functional attributes in different socio-political ecosystems.[51] For instance, national standardisation divergence reveals that Britain treats standards as competitive instruments within its liberal market economy (LME).[52] The reason behind it is that it reflects British common law tradition and imperial legacy.[53] Thus, in its self-driven market, their enterprises employ management standards like ISO 9000 to avoid legal liabilities, although this practice has precipitated technological hollowing-out.[54] The drawback of the trait is that as the standardisation shifted towards certification services, standardisation degenerated into a tool for low-end price wars, with corporations suppressing technological innovation due to the legal system's acute sensitivity to compliance risks.

In contrast, Germany's DIN standards, through its tradition of industry cartels and institutionalised government collaboration, embed technical specifications within the education, production, and supply chains. This integration forms a "regulatory infrastructure." This coordinated market economy (CME) mechanism is influenced by the social market economy

[51] Vittorio Valli, 'The Contemporary History of Comparative Economic Studies' in Bruno Dallago and Sara Casagrande (eds) (2022), note 49, 19.

[52] Jay Tate, 'National Varieties of Standardization' in Peter A Hall and David Soskice (eds) (2001), note 49, 446-451.

[53] Andrei Kuznetsov and Marcus Jacob, 'Convergence versus Divergence: Testing Varieties of Capitalism Perspective on the Globalization of Business Practices' in Svetla Marinova (ed), *Institutional Impacts on Firm Internationalization* (Palgrave Macmillan 2015) 12-39.

[54] Ibid.

ideology's consensus on collective interests and the high autonomy of industrial organisations. Thus, transplanting Germany's standardisation model to countries lacking collaborative industrial cultures would inevitably fail due to the inability to mobilise non-market coordination resources. It has shown that institutions with analogous functions, when implanted into divergent political soils, are often deconstructed into distinct institutional forms.[55]

Research further shows how institutional differences fundamentally reflect ideological constructions of "risk-responsibility" relationships across market economy models. For example, German high-skill enterprises support wage-linked unemployment insurance due to its complementarity with incremental innovation patterns,[56] whereas some American high-skill industries depend on state-mediated risk dispersion because they resist redistribution and count it as costs.[57] This divergence stems from CME and LME's contrasting value hierarchies due to "control rights": German firms perceive social security as public goods safeguarding skill investments, while American counterparts view them as cost burdens. Thus, the transplantation

[55] Ibid [452-463].

[56] Isabela Mares, 'Firms and the Welfare State: When, Why, and How Does Social Policy Matter to Employers?' in Peter A Hall and David Soskice (eds) (2001), note 49, 184-212.

[57] Martin R Schneider, 'Labor-Management Relations and Varieties of Capitalism' in Klaus F Zimmermann (ed), *Handbook of Labor, Human Resources and Population Economics* (Springer 2022) 1-18. <https://doi.org/10.1007/978-3-319-57365-6_212-1> accessed 12 April 2025.

of institutions that neglect such ideological disparities would risk triggering intense interest group confrontations.

Beyond socio-political and ideological perspectives, the efficacy of legal systems remains fundamentally rooted in specific cultural genes. Here, legal frameworks in Germany and the U.S. demonstrate that the German legal system's operational effectiveness originates from genetic-level consistency between institutional design and sociocultural norms. For example, the judicial application of the "good faith principle"[58] in the German Civil Code (BGB) essentially injects communal consciousness into the legal fabric.[59] When courts use this principle to declare unilateral risk clauses in contracts with the automotive industry unenforceable, they are drawing on societal consensus regarding the legitimacy of group effort rather than just codified statutes.[60] This cultural uniqueness makes it possible for court decisions and industry associations' technical specifications to work in concert, giving legal implementation a strong ability to mobilise society. In contrast, cross-cultural comparisons reveal that American society's cultural worship of individualism has shaped a diametrically distinct institutional landscape. That is, while the principle of contractual freedom ostensibly ensures market vitality, it

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[58] BGB § 242 (Leistung nach Treu und Glauben) Der Schuldner ist verpflichtet, die Leistung so zu bewirken, wie Treu und Glauben mit Rücksicht auf die Verkehrssitte es erfordern.

[59] Isabela Mares, 'Firms and the Welfare State: When, Why, and How Does Social Policy Matter to Employers?' (2001), note 56, 184-212.

[60] Karl Bork and Manfred Wandt, '"Utmost" Good Faith in German Contract Law' (2020) 109 Zeitschrift für die gesamte Versicherungswissenschaft (ZVersWiss) 243-254 <https://doi.org/10.1007/s12297-020-00478-6> accessed 12 April 2025.

fundamentally reflects societal aversion to collective coordination mechanisms.[61]

Notably, in developing nations where legal modernisation is undergoing, indigenous cultural traditions particularly exert foundational influences on constructing contemporary legal frameworks. Research on formal-informal institutional dynamics in Southeastern Europe reveals that transplanted Western legal systems often face significant rejection when Western legal systems encounter native cultural traditions.[62] Here, the empirical data indicate citizens' predominant preference for resolving disputes through kinship networks over legal channels. Thus, this behavioural pattern reflects the exclusionary effects of deep-seated cultural norms on alien institutions. Moreover, the Bosnian study of business licensing exemplifies this paradox: despite formal compliance with statutory procedures, substantive decision-making authority remains embedded in Balkan trust networks cultivated over centuries. This mode of business reduces modern law to mere formalities.[63] This "dual-track structure of legal formalism and traditional substance" functions as an institutional immune response, rejecting transplanted

[61] Edward Grabb, Douglas Baer and James Curtis, 'The Origins of American Individualism: Reconsidering the Historical Evidence' (1999) Canadian Journal of Sociology 511, 516.

[62] Alena Ledeneva and Adnan Efendic, 'The Rules of the Game in Transition: How Informal Institutions Work in South East Europe' in Ewa Douarin and Oleh Havrylyshyn (eds), *The Palgrave Handbook of Comparative Economics* (Palgrave Macmillan 2021) 811-845 <https://doi.org/10.1007/978-3-030-50888-3_31> accessed 11 April 2025.

[63] A Efendic and A Ledeneva, 'The Importance of Being Networked: The Costs of Informal Networking in the Western Balkans Region' (2020) 44(4) Econ Syst 100784, 100788.

frameworks while preserving indigenous social structures. [64] That is, the above research warns that developing countries risk constructing legally impotent systems if they fail to organically integrate indigenous cultural elements into institutional design during rule-of-law construction.

In summary, the success or failure of legal transplantation and reform depends on the deep adaptation to the logic of informal institutions. Comparative economic studies have shown that transplanting institutions detached from cultural genes and the political ecology is likely to trigger “institutional rejection”: the German coordinated market economy relies on industry self-governance and social consensus, while the American free market model is rooted in a tradition of individualism; both create a complementary resonance between formal and informal institutions. The rule-of-law challenges in developing countries often arise from the “technical imitation” of heterogeneous institutions—for example, when Southeast Europe adopts Western legal systems, traditional trust networks continue to dominate substantive decision-making, rendering the law a mere formal shell. All in all, institutional change must be anchored in local soil: it requires not only activating the compatibility between traditional rules and modern

[64] Alena Ledeneva and Adnan Efendic (2021), note 62, 819-820.

governance, but also gradually fostering an ideological consensus to achieve an organic integration of the legal system with informal norms.

2.2 Calibrating Institutional Responses to Functional Magnitude

The essence of legal transplantation is not the mechanical transfer of foreign legal texts, but rather an adaptive reconstruction process based on the institutional ecology of the recipient society. In this process, besides the need to accommodate informal institutional factors such as the ones we have discussed above, the intensity of functional demands (functional magnitude) serves as the core regulating variable in institutional transplantation.

The key proposition revealed by the “functional magnitude” argument is that different societies exhibit significant heterogeneity in both the intensity of their demand for specific institutional functions and the means by which these functions are realised; this magnitude difference directly determines the feasibility boundaries and transformational dimensions of legal transplantation.[65]

In the context of comparative capitalism, although considerable differences exist in the informal institutional traditions of various countries,

[65] See Chapter V Section 3.

variations in the intensity of functional demands could still constitutes an important and convergent driving force of institutional evolution.

For example, CMEs represented by Germany and Sweden, despite having differentiated informal institutional traditions, rely deeply on industrial coordination and social stability as core competitive advantage, thereby generating a strong functional demand for highly stable labour relations. This demand directly leads to the emergence of convergent, long-term industry-level coordination mechanisms and collective bargaining systems, which maintain production system stability through institutionalised labour–capital negotiations.[66]

Similarly, under the economic logic of contractual freedom and market flexibility, LMEs in the U.K. and U.S. only generate a weak functional demand for stable labour relations. This market logic naturally results in a de-collectivised institutional design, including the weakening of trade unions and the development of an employer-led individualised employment model, thereby ensuring that capital can quickly respond to market changes.[67]

Therefore, although the core functions of their institutional designs share a common origin—maintaining a dynamic balance between labour and

[66] Kathleen Thelen, 'Varieties of Labor Politics in the Developed Democracies' in Peter A Hall and David Soskice (eds) (2001), note 49, 71-103 <https://doi.org/10.1093/0199247757.003.0002> accessed 12 April 2025.

[67] Ibid.

capital relations and optimising production efficiency, this institutional dynamic essentially stems from differences in the intensity of specific functional demands across different market economic models (institutions), revealing the core essence of the "functional magnitude" argument: different societies may have similar goals for institutional functions but at varying intensities, and thus formal institutional designs will still exhibit differentiated evolutionary paths.

To better highlight the significance of the function magnitude variable, it follows that even if different countries share similarities in their informal institutions (a control variable), as long as differences in the magnitude of functional demands, their formal institutional design paths may be entirely different.

For example, in the field of health policy in post-communist countries, institutional design is closely related to the magnitude of the functions that society needs to address.[68] Historically, Eastern European and former Soviet countries achieved initial success in the post-war period through unified planning of basic health care and infectious disease control measures—a stage at which a relatively simple institutional system could adequately meet

[68] Eg J Elster, C Offe and U K Preuss, *Institutional Design in Post-Communist Societies: Rebuilding the Ship at Sea* (Cambridge University Press 1998) 63-155.

basic health needs.[69] However, with the emergence of more complex health issues such as cardiovascular diseases, this singular, centrally planned model began to reveal its limitations. In countries with relatively similar informal institutions, when confronted with high-level functional challenges, the existing institutional model lacked the necessary adaptability highly likely would fail to effectively reduce cardiovascular mortality and improve life expectancy. This process clearly demonstrates that different levels of functional demand inevitably drive institutional design along divergent paths. Only those countries that can implement timely and effective institutional reforms and structural adjustments in the face of complex and high-level health challenges are able to genuinely improve overall health outcomes.[70]

In summary, the concept of “functional magnitude” reveals that institutional design should be closely aligned with the intensity of societal functional demands rather than merely being restricted by form or tradition. If legal transplantation disregards the specific functional challenges and carrying capacity of the target society, it will be difficult for it to truly take root and flourish.

2.3 Path Dependence Features and Systemic Risk Management

[69] Christopher J Gerry, ‘Explaining the Heterogeneity of Health Outcomes in Post-Communist Europe’ in Ewa Douarin and Oleh Havrylyshyn (eds) (2021), note 62, 589-615.

[70] Ibid.

In the context of globalisation and the exchange of institutional ideas among nations, legal transplantation serves as an important means of institutional innovation and transformation. However, once any legal system is introduced, it inevitably faces interactions and friction with the existing legal framework and the overall mechanism of social governance. Thus, effective implementation of legal transplantation requires careful consideration of the dynamic relationship between the existing system and the new one. Otherwise, the two systems may not only generate normative conflicts but also suffer from functional overlaps. Ultimately, the neglect will result in resource waste and diminish economic efficiency.[71]

New and existing institutions often exhibit complex interactive relationships. Neglecting this contextual factor can easily lead to functional conflicts and ultimately result in uneconomical outcomes. For example, the developmental trajectory of Germany's social insurance system provides an exemplary reference. During the Bismarck era, Weimar Republic period, and the recent decades of early retirement policy development, German employers demonstrated varied responses to social insurance policies. In these policy designs, two dimensions — risk redistribution and managerial control — constituted crucial value considerations. Here, risk redistribution reflects the system's function of transferring and equalising risks, while

[71] See Chapter V Section 4.

control represents employers' desire to maintain participation in system operations to protect their interests.[72] Thus, when designing new institutions, if established risk-sharing mechanisms and management practices in existing systems are overlooked, newly introduced systems may conflict with original legal institutions in terms of functions, leading to increased costs for all parties, decreased resource allocation efficiency, and uneconomical effects.

Similarly, observing the shifting attitudes of employers across different historical periods further reveals that the influence of pre-existing institutional factors on new systems cannot be ignored. For instance, when disability insurance was introduced during the Bismarck era, industries demonstrated varying acceptance of redistribution policies, with their responses closely tied to sector-specific risk exposures. Specifically, high-risk industries actively supported extensive redistribution, while low-risk sectors opposed it. This is because pre-existing enterprise risk structures and industry practices had already formed a stable institutional context. Thus, if the design of new systems is too radically divorced from reality, it would force conflicts between traditional and new institutions, disrupting established economic interest balances.

[72] Isabela Mares, 'Firms and the Welfare State: When, Why, and How Does Social Policy Matter to Employers?' (2001), note 56, 204-209.

Further, in such circumstances, directly transplanting external institutions or blindly conducting legal transplants may overlook the structural characteristics of the existing legal system. This may make new institutions incompatible with original ones and cause functional conflicts and resource waste. As highlighted in *Legal Irritants: How Unifying Law Ends Up in New Divergences*, conceptualising legal rules as transplantable "organs" ignores the symbiotic relationship between rules and institutional ecology. [73] The transplantation of the "good faith principle" within the EU serves as an example. "The good faith principle" in German law is rooted in coordinated market economy systems, functioning to balance long-term cooperative relationships among shareholders, employees, and suppliers. When transplanted to the U.K., this principle encountered the common law tradition of contractual freedom. Due to characteristics of British production systems, it might not be accepted as a rule promoting cooperation and trust, but rather perceived as restricting economic behaviour[74] —one may further evolve into a tool for judicial intervention in commercial decisions. Thus, it has shown that the essence of this functional alienation lies in insufficient evaluation of functional complementarity and exclusivity during rule transplantation. When new rules overlap functionally with existing institutions in the same

[73] G Teubner, 'Legal Irritants: How Unifying Law Ends Up in New Divergences' in P A Hall and D Soskice (eds) (2001), note 49, 417-441.

[74] Eg R Boyer, 'Is a Finance-Led Growth Regime a Viable Alternative to Fordism? A Preliminary Analysis' (2000) 29(1) Econ Soc 111, 123.

social domain, normative conflicts may emerge, effectively increasing compliance costs for market participants.

The introduction of new institutions that disregard existing institutional structures can similarly lead to functional overlaps between systems, resulting in uneconomical resource allocation consequences. Taking contract law in corporate governance as an example, Casper's study provides a detailed comparison of significant differences between Germany and the United States in contract law regulation of corporate governance: Germany tends to employ contract standard systems jointly constructed through regulatory legislation and industry associations, emphasising risk-sharing and industry coordination mechanisms, whereas the U.S. primarily relies on classical contract law centred on "private law autonomy," driven by bottom-up private law mechanisms for contractual arrangements.[75] These institutional arrangements each possess inherent logic and stable structures. In this context, simply transplanting American contract governance mechanisms into Germany without considering the role of Germany's original regulatory-oriented and industry coordination systems might create institutional functional overlaps. Specifically, when the private law adjustment mechanisms in classical

[75] S Casper, 'The Legal Framework for Corporate Governance: Explaining the Development of Contract Law in Germany and the United States' (Discussion Paper FS I 98-303, Wissenschaftszentrum Berlin für Sozialforschung 1998) 28 < https://www.ssoar.info/ssoar/bitstream/handle/document/12918/ssoar-1998-casper-the_legal_framework_for_corporate.pdf?sequence=1&isAllowed=y&lnkname=ssoar-1998-casper-the_legal_framework_for_corporate.pdf > accessed 15 April 2025.

contract law coexist with Germany's existing regulatory-oriented contract standard systems, enterprises handling contract disputes would face two sets of institutionally different arrangements. This would not only increase judicial adaptation costs and legal application uncertainties for enterprises but could also create "polycentric governance" dilemmas in institutional design, thereby raising compliance costs and impairing overall operational efficiency of the system.

In conclusion, legal transplantation must carefully align with the underlying principles of the domestic legal system—it cannot simply copy foreign institutions. When newly introduced institutions lack connection to existing ones, they risk creating functional conflicts, redundancies, and inefficiencies. Therefore, institutional reforms should preserve compatibility with the current framework while remaining adaptive to new functional demands. To prevent the "rejection effect"—where transplanted institutions lead to systemic dysfunction—gradual implementation and greater coordination between systems are essential.

3. Critical Limitations in Empirical Analysis

Although empirical analysis is an essential methodology in comparative legal studies, this study critically examines the reconstruction of securities litigation through a comparative legal analysis framework grounded in the theory of institutional complementarity and deliberately avoids empirical analysis. The rationale for this approach lies in the inherent limitations of empirical methods—particularly in comparative legal scholarship—which often prioritise quantifiable metrics at the expense of contextual nuance.[76] For example, although influential, the LFS marginalises the role of informal institutions like market culture, social norms, and relational governance while placing excessive emphasis on formal legal institutions.

3.1 Neglect of Social Context in Corporate Governance Analysis

The LFS's empirical research prioritises formal legal institutions—minority shareholder protections, anti-director rights—as analytical determinants of market stability and investor behaviour. For instance, their findings in corporate governance analysis correlate robust legal safeguards with reduced stock volatility during crises and higher dividend payouts in stable markets.[77]

[76] Critics argue that LFS studies employ questionable variables and flawed conclusions. Glaeser et al. dispute the causal link between political institutions and economic growth, emphasising East Asia's reliance on human capital and state policies over democracy. E L Glaeser et al., 'Do Institutions Cause Growth?' (2004) 9(3) J Econ Growth 271-303. Cross-national research critiques omitted variables, stressing interactions between macro factors (public governance, geography) and micro-level data. E Schiehll and H C Martins, 'Cross-National Governance Research: A Systematic Review and Assessment' (2016) 24(3) Corp Gov Int Rev 181-199. LFS overemphasises legal origins' economic impact, neglecting political/historical factors (Eg wars, inflation). R G Rajan and L Zingales, 'The Great Reversals: The Politics of Financial Development in the Twentieth Century' (2003) 69 J Finance Econ 5-50. Musacchio notes ownership-control separation in both common and civil law systems, challenging legal determinism. A Musacchio and J D Turner, 'Does the Law and Finance Hypothesis Pass the Test of History?' (2013) 55(4) Bus Hist 524-542.

[77] Eg R La Porta et al., 'Legal Determinants of External Finance' (1997) 52(3) J Finance 1131-1150; R La Porta et al., 'Law and Finance' (1998) 106(6) J Polit Econ 1113-1155; R La Porta et al., 'Corporate Ownership Around the World' (1999) 54(2) J Finance 471-517; R La Porta et al., 'Investor

However, this analytical framework makes a key mistake by assuming that legal institutions function apart from the cultural soil and social ecosystems. For example, corporate governance systems are always influenced by informal social infrastructure, such as industry-specific ethical codes, stakeholder trust networks, and community-enforced norms. This contradiction can be evidently found in the business environment in China. In China, clan-based governance in family businesses and guanxi-mediated trust relationships enable entire industries to thrive over the past 40 years even though official shareholder protections theoretically fall short of Western standards. [78] Specifically, these informal institutions provide "formal solutions" to resolve agency problems and mobilise capital without recourse to formal legal architectures, achieving outcomes comparable to mature regulatory systems.[79]

Building on this and similar considerations, critics argue that the dominant literature is prone to three analytical errors: [80] (1) misdiagnosing the drivers of governance effectiveness, (2) overestimating the transferability of Anglo-American legal templates, and (3) underestimating the adaptive

Protection and Corporate Governance' (2000) 58(1) J Finance Econ 3-27; R La Porta et al., 'Agency Problems and Dividend Policies Around the World' (2000) 55(1) J Finance 1-33; R La Porta et al., 'Investor Protection and Corporate Valuation' (2002) 57(3) J Finance 1147-1170.

[78] U C Braendle, T Gasser and J Noll, 'Corporate Governance in China: Is Economic Growth Potential Hindered by Guanxi?' (2005) 110(4) Bus & Soc Rev 389-405.

[79] Y Li, G G Tian and X Wang, 'The Effect of Guanxi Culture on the Voting of Independent Directors: Evidence from China' (2021) 67 Pacific-Basin Finance Journal 101524, 101537.

[80] G Schnyder et al., 'Twenty Years of "Law and Finance": Time to Take Law Seriously' (2021) 19(1) Socio-Econ Rev 377-406.

capacity of localised systems. The resultant legal transplantation strategies often prove counterproductive, as we have discussed in Section 2.1, when imposed on societies where informal norms outweigh codified rules.

3.2 Cultural Amnesia in Capital Market Regulation

The LFS framework also emphasises the role of formal securities institutions such as mandatory disclosure regimes and private enforcement mechanisms. Here, empirical studies arguably claim that ex ante disclosure requirements and ex post investor litigation reduce information asymmetry and deter securities violations.[81] However, this perspective neglects how culture and behaviour shape market participation.[82]

Market culture, defined as shared beliefs about fairness, risk-taking, and regulatory legitimacy, profoundly influences how formal rules are interpreted and enforced. In jurisdictions with a strong culture of industry-driven regulation—such as Germany's Deutschland AG model, where industry associations enforce compliance through peer pressure—formal legal

[81] Eg T Beck et al., 'Finance and the Sources of Growth' (2000) 58(1) J Finance Econ 261, 293; S Mengoli et al., 'Effect of Governance Reforms on Corporate Ownership in Italy: Is It Still Pizza, Spaghetti, and Mandolino?' (2009) 17(5) Corp Gov Int Rev 629,643; S Djankov et al., 'The New Comparative Economics' (2003) 31(4) J Comp Econ 595, 614; R Levine, 'Law, Finance, and Economic Growth' (1999) 8(1-2) J Finance Intermediation 8, 33; P Bordalo et al., 'Diagnostic Expectations and Stock Returns' (2019) 74(6) J Finance 2839, 2873-2874; E L Glaeser and A Shleifer, 'The Rise of the Regulatory State' (2003) 41(2) J Econ Lit 401, 423-425; R La Porta et al. (2006), note 3, 27-28; J R Hay and A Shleifer, 'Private Enforcement of Public Laws: A Theory of Legal Reform' (1998) 88(2) Am Econ Rev 398, 401-402; S Djankov et al., 'The Law and Economics of Self-Dealing' (2008) 88(3) J Finance Econ 430, 463.

[82] A Musacchio and J D Turner (2013), note 76, 524-542

enforcement may play a secondary role.[83] Conversely, in markets with a history of state-led economies, such as China, investors may prioritise political connections over legal protections when assessing risk.[84] Thus, these cultural factors shape the effectiveness of formal rules but remain invisible in LFS empirical analysis, which primarily relies on cross-country indices of legal variables. By failing to account for market culture, the empirical analysis risks overestimating the universal applicability of the design of institutions.

3.3 Litigation-Centric Bias in Dispute Resolution

While LFS scholars emphasise private litigation's role in institutional functions,[85] they underestimate how social norms like informal dispute resolution bypass formal legal processes. The following examples illustrate this divergence. In the U.S., the widely applied class actions reflect a litigious culture,[86] whereas Japanese firms traditionally relied on behind-the-scenes negotiations (nemawashi) to avoid conflict in the courts.[87] Similarly, in China, the government promotes the "Fengqiao Culture" and the "Fengqiao

[83] J Edwards and M Nibler, 'Corporate Governance in Germany: The Role of Banks and Ownership Concentration' (2000) 15(31) Econ Policy 238, 241.

[84] S Heilmann, 'The Chinese Stock Market: Pitfalls of a Policy-Driven Market' (2002) 15 China Analysis 1, 4 <http://chinapolitik.org/files/no_15.pdf> 24 June 2025.

[85] Eg P G Mahoney, 'The Common Law and Economic Growth: Hayek Might Be Right' (2001) 30(2) J Legal Stud 503-525; R Levine, 'Law, Endowments and Property Rights' (2005) 19(3) J Econ Perspect 61-88.

[86] See Chapter V Section 2.2.

[87] D Zhang and K Kuroda, 'Beware of Japanese Negotiation Style: How to Negotiate with Japanese Companies' (1989) 10(2) Nw J Int'l L & Bus 195, 199.

Experience," encouraging parties to resolve disputes not through litigation, but through community mediation as an alternative means of dispute resolution.[88]

These informal resolution practices contradict LFS assumptions positioning legal enforcement as central to market efficiency. While industries are developing, formal law becomes just one element within a broader governance ecosystem.

3.4 Implications for Legal Design and Reform

The finding that LFS's empirical analysis neglects non-formal institutions carries significant implications. If Policymakers primarily rely on its recommendations, it will prioritise legal transplants without considering local cultural or industry contexts, ultimately leading to "institutional mismatch."

Therefore, future research should adopt a more holistic comparative approach which should integrate non-formal institutions into analyses of legal-economic works. This approach could involve qualitative studies of local industry practices, market culture and behaviour, or comparative institutional systems where formal and informal rules coexist. By doing so,

[88] Jia Chen and Xiao Fang, 'Institutionalized Operation and Life Practice of Folk Traditions in the "Fengqiao Experience"' (2024) 9 Xuexi yu Shijian 42-51.（贾琛、萧放：《"枫桥经验"中民俗传统的制度化运作与生活实践》，载《学习与实践》，2024 年第 9 期，第 42-51 页）

scholars can develop a richer understanding of how law interacts with societal norms to shape institutional functions that lead to ideal economic outcomes.

In sum, while the LFS has provided invaluable insights into the function of formal legal institutions in the development of economy, its neglect of non-formal institutions limits its explanatory and prescriptive power. Thus, a more inclusive and holistic theoretical framework must incorporate the complementary roles of market culture, industry practices, social norms and other non-formal institutional factors, and it would be more meaningful for understanding the complex realities of the global economy.

4. Critical Limitations in Conventional Comparative Approaches

Focused on institutional complementarity theory, the study systematically evaluates the reform of securities litigation via comparative legal analysis, consciously diverging from traditional comparative methodologies, such as functionalism and contextualism. The rationale for this methodological exclusion stems from fundamental limitations in conventional paradigms. The Law and Economics Comparative Functionalist Approach (LECFA), while effective in identifying functional equivalents across jurisdictions, manifests critical shortcomings through its neglect of differential functional magnitude. Moreover, contextualist approaches, though valuable in emphasising cultural embeddedness, frequently succumb to cultural determinism that underestimates institutional adaptability. By systematically exposing these analytical deficiencies, this section establishes the theoretical imperative for the novel comparative methodology in this study that reconciles institutional complementarity with insights in conventional comparative approaches.

4.1 The Law and Economy Comparative Functional Approach (LECFA): Oversights in Relation to Functional Magnitude

An important methodological development in legal scholarship is the LECFA, which primarily bridges the gap between economic analysis and comparative law.[89] Here, LECFA aims to find functionally equivalent legal components across jurisdictions that address common economic issues such as agency costs, shareholder protection, or corporate governance by linking the comparative legal method with law and economics (L&E) theory.[90] However, LECFA frequently ignores the crucial aspect of functional magnitude, even though it is excellent at emphasising functional convergence—the existence of comparable legal institutions to accomplish comparable goals. This omission limits the explanatory power of LECFA

[89] Eg A Watson, *Legal Transplants: An Approach to Comparative Law* (2nd edn, University of Georgia Press 1993) 1.

[90] Eg Richard A Posner, *Economic Analysis of Law* (9th edn, Wolters Kluwer Law & Business 2014) ch 2.

because, even when jurisdictions have similar functional goals, differences in functional magnitude can result in radically different institutional designs.

4.1.1 Functional Convergence as Methodological Foundation

Fundamentally, LECFA is based on the functionalist tradition in comparative law, as stated by Zweigert and Kötz. This tradition holds that legal systems that encounter comparable social or economic problems will produce solutions that are functionally equivalent, despite differences in their doctrinal frameworks.[91] For instance, jurisdictions may adopt distinct legal rules to mitigate agency problems between shareholders and managers—such as fiduciary duties in common law systems or codified director liabilities in civil law systems—but these rules ultimately serve the same economic function of aligning managerial incentives with shareholder interests. This functional equivalence is essential to LECFA's methodology, which compares how various jurisdictions handle common economic goals in an effort to distil "optimal" legal features.[92]

Works like *The Anatomy of Corporate Law*, which strongly supports a "common core" of corporate law principles across jurisdictions, such as procedures to resolve conflicts of interest or safeguard minority shareholders,

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[91] Eg Konrad Zweigert and Hein Kötz, *An Introduction to Comparative Law* (Tony Weir tr, 3rd rev edn, Clarendon Press 1998) ch 1.

[92] Alan Dignam and Michael Galanis, *The Globalization of Corporate Governance* (Ashgate 2009) 110; Mathias M Siems, *Convergence in Shareholder Law* (CUP 2008) 226.

serve as examples of the functionalist strategy.[93] By focusing on economic functions rather than doctrinal forms, LECFA transcends formalistic comparisons and emphasises the adaptability of legal systems to universal economic imperatives. This aligns with the "end of history" theory in corporate law, which suggests a global convergence toward shareholder-centric models driven by market efficiency and investor welfare.[94]

4.1.2 The Strengths and Limits of Functional Convergence

LECFA's emphasis on functional convergence offers valuable insights, particularly in an era of economic globalisation. By identifying legal elements that perform equivalent economic roles, it enables policymakers to borrow and adopt foreign institutional solutions for domestic settings.[95] For example, securities litigation frameworks in one jurisdiction might inspire reforms in another, provided they address similar functional issues such as information asymmetry or irrational investors behaviour.

However, LECFA's singular focus on functional equivalence risks oversimplifying the complexity of legal design. While two jurisdictions may share a commitment to "investor protection" as a functional goal, the degree

[93] John Armour et al (2017), note 17, 29.

[94] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2001) 89 Geo LJ 439, 443.

[95] Eg Martin Gelter and Kristoffel R Grechenig, 'History of Law and Economics' in Jürgen G Backhaus (ed), *Encyclopedia of Law and Economics* (Springer 2014) 1248-1254.

to which they prioritise this objective can vary dramatically.[96] For instance, the U.S. employs a robust private securities litigation regime characterised by class actions and extensive damages, whereas the U.K. relies more on public enforcement through regulatory agencies like the FCA.[97] These differences reflect not just doctrinal preferences but divergent assessments of functional magnitude: the market conditions in U.S. demand a legal system that prioritises deterrence and compensation at the cost of potential litigation abuse, while the U.K. emphasises stability and proportionality, aligning with its institutional investor market structure. In contrast, LECFA's framework, by treating "investor protection" as a binary function (present or absent), fails to account for how gradations in functional magnitude shape institutional choices.

4.1.3 Functional Magnitude: A Missing Dimension in LECFA

Functional magnitude proves essential as it captures how jurisdictions balance normative ideals with practical realities. While two legal systems might recognise the necessity of a shared institutional function, their divergent assessments of its optimal scale fundamentally shape institutional design. The following examples illustrate this critical yet underappreciated dimension:

[96] See Chapter V Section 3.
[97] See Chapter V Section 1.4.

Investor Protection Paradigms: While all jurisdictions universally condemn securities fraud (similar function), their regulatory approaches to enforcement and deterrence yield markedly divergent frameworks for investor protection. For example, in the U.S. securities litigation system, it enforces comparatively stringent certification requirements to avoid frivolous litigation and primarily relies on the large scope of accountability through its market-driven private litigation. However, China's securities dispute resolution process intentionally restricts the scope of litigation through state-led enforcement (CSISC-led), placing individual remedies below macroeconomic objectives and systemic market stability.[98] These disparities stem not from the gap of functional recognition, but from calibrations of functional magnitude—whether the calibration favours economic interests or individual rights.

Enforcement Philosophy Spectrum: The functional magnitude of securities enforcement is shaped by market needs. In the U.S., the securities market is characterised by its vast scale, fragmented ownership, and high liquidity. The nature of the market shapes a high functional magnitude for private securities enforcement. This is exemplified by class action mechanisms, which harness market-driven deterrence as a tool for market regulation. In stark contrast, the U.K.'s market is characterised by a

[98] See Chapter V Section 3.3.

comparatively smaller capital base, institutional ownership concentration, and moderate liquidity. This market can be served by a high functional magnitude for public enforcement instead of private securities litigation because it can emphasise preventative supervision and targeted administrative interventions, prioritising market continuity over disruptive sanctions. These divergent strategies underscore a fundamental tension between enforcement mechanisms and functional realities.[99]

4.1.4 Implications for Legal Design and Reform

There are undesirable consequences when functional magnitude is neglected. This is because that legislators run the risk of referring to institutional solutions that aren't compatible when they move legal institutions merely based on functional equivalence. For instance, bringing U.S.-style securities class actions into a jurisdiction with inadequate judicial capacity may result in unintended consequences or worsen inefficiencies.

In conclusion, the LECFA framework has undeniably enriched comparative legal studies by highlighting the economic rationality underlying seemingly disparate legal institutions. However, its preoccupation with functional convergence at the expense of functional magnitude limits its utility as an ideal tool for institutional design. By incorporating "functional

[99] See Chapter V Section 3.1 and 3.2.

magnitude" into its analysis—asking not just what functions legal systems serve but how much they prioritise or should prioritise them—comparative analysis could offer a more holistic understanding of institutional diversity.

4.2 Contributions and Limitations of Contextualism and Its Integration with Path Dependence Theory

4.2.1 Contextualism's Analytical Impasse

Contextualism, as a critical philosophical counterpoint to the functionalist's comparative approach, fundamentally challenges the latter one's pursuit of universal legal principles. As we have discussed above, functionalism attempts to establish common institutional frameworks through "functional equivalence." In contrast, contextualism emphasises that institutions cannot be directly comparable because institution is an organic entity shaped by specific historical context, cultural traditions, social norms, and political dynamics.[100] As what Pierre Legrand expressly opposes, legal institutions cannot be mechanically transplanted because they should be conceptualised as a "living practice" that grows organically from a region's unique historical and cultural soil.[101]

[100] Christopher M Bruner, 'What Is the Domain of Corporate Law?' (University of Georgia School of Law Legal Studies Research Paper No. 2019-04, 15 January 2019) 28-39 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3308611> accessed 15 April 2025.

[101] C M Bruner, 'Methods of Comparative Corporate Governance' in A Afsharipour and M Gelter (eds), *Comparative Corporate Governance* (Edward Elgar Publishing 2021) 20.

While this study agrees with the foundation of what Pierre Legrand said, merely applying contextualism without refinement reveals its inherent theoretical limitations. Firstly, its overreliance on cultural differences risks circular reasoning: By routinely explaining legal variations through appeals to "cultural uniqueness," the theoretical conclusion risks reducing "culture" to a mere item for difference—one that lacks explanatory power regarding specific causation between the cultural context and institutions.[102] Further, contextualism's refusal to engage in normative evaluations of legal institutions, which renders it incapable of addressing real-world demands for institutional reform. As Russell Miller claims, if all differences are deemed equally legitimate to exist, a comparative work would become a "museum of legal anthropology," losing its capacity to inspire institutional optimisation.[103] Thus, these theoretical flaws stop contextualism to the elementary stage of "presenting differences," preventing it from fulfilling a normative and practical function for legal transplantation.

4.2.2 Path Dependence as a Synthesising Framework

To transcend contextualism's theoretical impasse, the introduction of path dependence theory offers a possible solution. For instance, in explaining why

[102] M Siems, *Comparative Law* (3rd edn, Cambridge University Press 2022) 15-49.

[103] R A Miller, 'Comparative Law and Germany's Militant Democracy' in R A Miller (ed), *US National Security, Intelligence and Democracy: From the Church Committee to the War on Terror* (Routledge 2008) 229.

English common law resisted the codification trends of civil law systems, contextualism might emphasise English common law tradition that precedents serve as the legal source for the vast majority of judicial cases, making comprehensive codification unnecessary. However, path dependence theory may claim that common law tradition underscores the "institutional stickiness" inherent in common law systems when undertaking systemic reforms. Thus, the advantages of codification—as exemplified by legislation such as the Financial Services and Markets Act 2000—can only be selectively incorporated to enhance legal frameworks under exceptional circumstances.

Further, the integration of path dependence and contextualism facilitates pragmatic solutions. By distinguishing between "strong path dependence" in traditional domains (e.g. traditional property rights) and "weak path dependence" in emerging fields (e.g. data property rights), comparative scholars can design differentiated legal harmonisation strategies. In strongly path-dependent traditional domains, pragmatists may be better off abandoning illusions of transplanting certain legal reforms and instead explore "institutional interface" solutions.[104] For example, in China's rural land reform, which separated contractual rights, management rights, and collective ownership, a balance was achieved between path-breaking

[104] T Brenner and S zu Jeddeloh, 'Path Dependence in an Evolving System: A Modeling Perspective' (2024) 18 Cliometrica 1, 22.

innovation and institutional stability without replicating Western privatisation models.[105] In weakly path-dependent emerging fields, contextual analysis helps identify culturally compatible reform options. Developing countries constructing data governance regimes, for instance, might draw selectively from the EU's flagship General Data Protection Regulation (GDPR) while adapting it to local contexts.[106]

4.2.3 Implications for Legal Design and Institutional Reform

The theoretical synthesis of contextualism and path dependence signifies a methodological shift in comparative law—from "labelling differences" to "explaining and applying differences"—with profound implications for legal practice. When designing reforms, legislators must accurately assess the intensity of path dependence in target domains: in traditional fields, gradualist strategies could reconcile tradition with modernity; in weakly locked-in areas, bold institutional innovations can take place more decisively.

[105] Guan Hongyan, 'From "Separation of Two Rights" to "Separation of Three Rights": Institutional Change and Performance Analysis' (2023) 3 Henan Shehui Kexue 59, 60-66（管洪彦：《农地"两权分离"到"三权分置"：制度变迁与绩效分析》，载《河南社会科学》，2023 年第 3 期，第 60-66 页）

[106] Diao Shengxian and Qi He, 'Legal Countermeasures of Personal Information Leakage—A Comparative Study with GDPR' (2019) 3 Science Technology and Law 49, 54.（刁胜先、何琪：《论我国个人信息泄露的法律对策——兼与 GDPR 的比较分析》，载《科技与法律（中英文）》2019 年第 3 期，第 54 页）

5. Conclusion: Synergising Institutional Complementarity and Comparative Approaches

This study advocates a new normative analytical framework for comparative law research by integrating three major theoretical dimensions at the methodological level: firstly, the normative study of formal institutions within conventional comparative law; second, a modified functionalist (including functional magnitude) perspective on the efficiency of legal institutions; and thirdly, the principle of institutional complementarity found in the paradigms of comparative economics and comparative institutional economics. This richer comparative legal framework, when applied to the divergent securities litigation regimes in the U.S., U.K. and China, is better able to capture more nuanced insights. More importantly, the divergence of these securities litigation regimes, navigated through a sophisticated comparative methodology, provides answers to questions of functions and effectiveness, therefore relegating the simplistic quest for “the optimal legal design” which often results in inappropriate forms of legal transplantation.

Structural Organisation of the Study: The study is structured into three cohesive analytical phases. Chapter I establishes the foundational framework by introducing the central research question, articulating the methodological principles guiding the study, and defining the parameters of the comparative analysis. Chapters II through IV undertake a legal and institutional deconstruction of the formal securities enforcement regimes in three representative jurisdictions, the United States, the United Kingdom, and China. Chapter V synthesises these comparisons into a unified theoretical construct.

Functional Contributions of Each Chapter: The study intervenes critically in securities law scholarship by challenging the prevailing fixation on identifying a universal "optimal regulatory design." It argues that such efforts are inherently flawed, particularly in their assumption that U.S.-style private litigation mechanisms—resisted institutionally in the U.K. and incompatible with China's socialist legal infrastructure—can be normatively transplanted. Chapter I systematically defends the study's methodological originality, demonstrating how its comparative institutional complementarity analysis addresses gaps in existing literature. Chapters II to IV delineate the comparative legal subjects under examination, grounding the analysis in the distinct institutional landscapes of the three jurisdictions. Finally, Chapter V transcends the comparison by applying the methodological toolkit from Chapter I to construct an original framework for reassessing securities litigation reform.

Chapter II

Securities Enforcement in the United States

1. The Legal Framework of U.S. Securities Laws

1.1 Three Reforms of U.S. Securities Laws

The U.S. securities law framework—anchored by three foundational reforms—has established itself as a global benchmark for investor protection and enforcement efficacy.

The first reform emerged in response to early 20th-century financial crises.[107] Here, the Securities Act of 1933 enacted and mandated transparency by requiring companies to disclose financial details, operational risks, and other material information during securities offerings. The goal of this enactment is to empower investors to make well-informed decisions.[108] This was followed by the Securities Exchange Act of 1934,[109] which established the Securities Exchange Commission (SEC) to oversee market fairness,

[107] M A Bernstein, *The Great Depression: Delayed Recovery and Economic Change in America* 1929-1939 (Cambridge University Press 1987) 21.

[108] 15 U.S.C. § 77a et seq.

[109] 15 U.S.C. § 78a et seq.

enforce regulations, and adapt rules to evolving market dynamics.[110] The SEC's broad authority has been instrumental in maintaining transparency, preventing fraud, and fostering trust in capital markets. Taken together, these legal reforms marked the federal government's proactive intervention in securities laws, laying the groundwork for a structured and reliable financial ecosystem.[111]

Upon these groundworks, the next reforms further involve facilitating private enforcement mechanisms balanced against litigation abuse. Historically, private securities lawsuits were prone to frivolous claims.[112] The Private Securities Litigation Reform Act of 1995 (PSLRA) addressed this by raising pleading standards, requiring plaintiffs to present detailed evidence of fraud rather than generic allegations.[113] This reduced frivolous litigation while preserving legitimate claims. For enhancing the enforcement of PSLRA, the Securities Litigation Uniform Standards Act of 1998 (SLUSA) centralised large-scale securities cases in federal courts, overriding inconsistent state-level rulings.[114] By harmonising legal standards, SLUSA enhanced

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[110] Eg The most important agency is Securities and Exchange Commission which was ready by 15 U.S.C. § 78d.

[111] Roberta S. Karmel, 'Should Securities Industry Self-Regulatory Organizations be Considered Government Agencies' (2008) 14 Stan JL Bus & Fin 151, 153.

[112] John Smith, 'The Screening Effect of the Private Securities Litigation Reform Act' (2009) 6(1) Journal of Empirical Legal Studies 35-68.

[113] Pub. L. 104–67.

[114] Pub. L. 105-353. For class actions seeking damages on behalf of more than 50 people, state courts have no jurisdiction. However, for class actions involving no more than 50 people, the jurisdiction of state courts is not excluded.

predictability and reduced jurisdictional conflicts, ensuring cohesive enforcement of securities laws. Together, these reforms streamlined private litigation, protecting issuers from abusive litigation while maintaining investor redress avenues.[115]

Subsequent reforms addressed vulnerabilities exposed by corporate scandals and systemic crises. The Sarbanes-Oxley Act of 2002 (SOX) arose from accounting frauds like *Enron*.[116] SOX required companies to disclose internal controls and risks, imposed stricter legal liability on executives for financial statements, and mandated independent audit committees to oversee audits, reducing collusion between auditors and management.[117] Similarly, the Dodd-Frank Act of 2010 responded to the 2008 financial crisis by strengthening systemic oversight. It introduced stress tests to ensure the stability of financial institutions.[118] By enhancing transparency and institutional resilience, Dodd-Frank sought to prevent future crises while safeguarding investor interests.[119] These legal reforms further restored investor confidence through enhanced government authority.[120]

[115] Stephen Choi & Robert B. Thompson, 'Securities Litigation and Its Lawyers: Changes during the First Decade after the PSLRA' (2006) 106 Colum L Rev 1489, 1529.

[116] Pub. L. 107–204.

[117] Pub. L. 107-204 Tile I.

[118] Charles W. Murdock, 'The Dodd-Frank Wall Street Reform and Consumer Protection Act: What Caused the Financial Crisis and Will Dodd-Frank Prevent Future Crises' (2011) 64 SMUL Rev 1243-1250.

[119] Pub. L. 111–203.

[120] Pub. L. 107-204 Tile III.

In summary, this analysis of U.S. securities law reforms reveals an evolving enforcement framework that combines private litigation with increasing governmental oversight, ultimately creating a hybrid private-public cooperative system. Having established this structural foundation, this chapter turns to examine the key tenet of investor protection in U.S. securities legal framework, beginning with mandatory disclosure. Following the discussion of mandatory disclosure, Section 2 will examine the typical causes of actions used by investors seeking compensation. Class actions are covered in Section 3, which demonstrates how procedural considerations support private enforcement. Last but not least, Section 4 discusses public enforcement, demonstrating how the SEC exercises its jurisdiction to enforce securities laws and how private enforcement and public enforcement complement each other functionally.

1.2 Mandatory Disclosure

The foundation of mandatory disclosure provisions in the U.S. is the need for investors to have access to material information before making a well-informed decision. Additionally, mandatory disclosure keeps the capital allocation market efficient.[121]

[121] Merritt B Fox, 'Retaining Mandatory Securities Disclosure: Why Issuer Choice Is Not Investor Empowerment' (1999) 85 Virginia Law Review 1335, 1342.

1.2.1 Mandatory Disclosure in Prospectus

Where issuers wish to offer securities to the public (the primary market), mandatory disclosure duties apply in the issuance registration process.[122]

When securities offered by an issuer are not exempt from regulatory oversight, the issuer must register under Section 5 of the Securities Act of 1933. The registration requirements of this provision apply to any securities offered or sold through the mail or interstate commerce, including securities traded on stock exchanges and securities privately placed with a small number of investors. As a result, the issuer must submit a “Listing Registration Application” before beginning a public offering or securities sale. In order for investors to properly assess risks and opportunities, this legal document must contain comprehensive information about the business, the financial products being marketed, and the particulars of the offering.[123]

While Section 5 , the registration mandate, applies broadly to securities issuances, certain exclusion criteria permit issuers to bypass the duty of registration under defined conditions.[124] These exemptions include private placements and sales made.[125] For instance, under specific conditions, such

[122] Marc I Steinberg, *Rethinking Securities Law* (Oxford University Press 2021) ch 4 <https://doi.org/10.1093/oso/9780197583142.003.0004> accessed 27 May 2025

[123] 15 U.S. Code § 77e.

[124] 15 U.S. Code § 77c.

[125] 15 U.S. Code § 77c (b).

as targeting a restricted group of well-accredited investors and avoiding public promotional issuance, those offerings may qualify for exclusion from mandatory registration processes.[126]

As a supplement to Section 5, Section 7 grants the SEC comprehensive authority to regulate the contents of the "Application for Listing Registration Report."[127] Firstly, the issuer must give a thorough explanation of its business, including details about its competitors, market share, business model, strategic plans, and other relevant information.[128] This allows investors to better understand the issuer's financial growth prospects and business risks. Second, the issuer needs to submit its past performance information, including financial record such as revenue, profit, cash flow, and others.[129] This enables investors to evaluate the current financial health of the issuer's business activities. Thirdly, the issuer must furnish independently audited financial records to legally validate the reliability and precision of the disclosed data,[130] and investors must also have the ability to review pertinent details regarding the issuer's executive leadership, such as their career histories, qualifications, remuneration packages, and other relevant factors.[131]

[126] Frederick H. Thomforde Jr, 'Exemptions from SEC Registration for Small Businesses' (1979) 47 Tenn. L. Rev 1-23.

[127] 15 U.S. Code § 77g.

[128] 15 U.S. Code § 77g (a) (1).

[129] Ibid.

[130] Ibid.

[131] Ibid.

This is because investors can assess the issuer's exposure to legal and regulatory risks due to these disclosures. Last but not least, the issuer is required to reveal all relevant information about the securities offering, such as pricing, scale and volume, issuance schedule, and associated terms. Here, The SEC's EDGAR (Electronic Data Gathering, Analysis, and Retrieval) platform makes this information publicly available, enabling investors to perform in-depth due diligence and make well-informed investment decisions.[132]

Following the issuer's fulfilment of the duty of registration under Sections 5 and 7, Section 8 authorises the SEC to conduct a thorough examination of the materials provided.[133] If no significant defects or omissions are found in the documents during the review process, the submitted documents typically become effective within 20 days.[134] Specifically, the SEC may send the issuer "Deficiency Letters" suggesting changes if there are problems with the documents the issuer submitted,[135] and the SEC has the authority to reduce the documents' duration of effectiveness.

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[132] <https://www.sec.gov/edgar/about> accessed 18 June 2023. This system launched in 1993.

[133] 15 U.S. Code § 77h.

[134] 15 U.S. Code § 77h (a).

[135] <https://www.sec.gov/about/offices/ocie/ocieoverview.pdf> accessed 18 June 2023.

This authority encourages issuers to actively work with the SEC to correct any errors in the documents.[136]

It should be noted that Section 12(a)(1) of the Securities Act of 1933 functions as a complementary enforcement tool to Section 11, targeting issuers who fail to register securities that legally require registration. Section 12(a)(2) governs offerings exempt from registration—such as those involving unregistered disclosure materials—and allows investors to pursue legal action if the offering documents or verbal communication-offering include significant inaccuracies or omit critical related facts.

1.2.2 Continuing Mandatory Disclosure

Issuers additionally have duties to fulfil ongoing reporting (post-offering) mandates under the Securities Exchange Act of 1934, which compels them to publicly disseminate updates on material information. [137] The scope of these disclosures is tailored to the issuer's classification and the specifics of the data involved, and entities adhering to these persistent requirements are formally recognised as "reporting companies." [138]

[136] John Mulford, 'Acceleration under the Securities Act of 1933-A Postscript' (1966) 22 Bus. Law. 1087, 1088.

[137] 15 U.S.C. § 78m.

[138] <https://www.investor.gov/introduction-investing/investing-basics/glossary/form-10-k> accessed 19 June 2023.

Under the duty of continuing mandatory disclosure, issuers must regularly provide critical updates to the market via standardised filings, including annual (Form 10-K) and quarterly (Form 10-Q) reports.[139] Here, investors can learn more about corporate governance, operational plans, independently audited financial results, and management's projections for the future due to these disclosures. Thus, investors and other stakeholders are better able to assess risks and opportunities due to this transparency, which helps them make decisions about whether to buy, sell, or hold onto publicly traded securities.[140]

Beyond periodic disclosures, issuers classified as reporting companies must also adhere to immediate reporting mandates under Form 8-K.[141] Under Sections 14(a)-(c) of the Securities Exchange Act of 1934, such entities are in duty to promptly disclose significant developments—such as material events occurring during a shareholder proxy fight—to ensure transparency and compliance.[142] During a proxy fight, shareholders seek to gain proxy control to obtain more voting rights, which significantly impacts the issuer's

[139] <https://www.investor.gov/introduction-investing/investing-basics/glossary/form-10-q> 19 June 2023.

[140] Ibid.

[141] <https://www.sec.gov/about/forms/form8-k.pdf> 19 June 2023.

[142] 15 U.S.C. § 78n(a)-(c).

internal control and corporate governance. Such significant effects also influence potential investors' assessment of the issuer's business status.[143]

1.2.3 General Prohibition Clause on Mis-Disclosure

The U.S. securities law has developed to include more open-ended provisions that require full transparency in order to further improve investor protections. Significantly, Section 17(a) of the Securities Act of 1933 explicitly lays out liability for fraudulent conduct in securities transactions, introducing a general prohibition clause against deceptive practices.[144]

This general provision bars individuals and entities from: (a) Presenting false or incomplete material details that distort the accuracy of disclosures; (b) Engaging in activities that defraud or mislead stakeholders during securities offerings. It should be noted that these provisions apply universally to all parties involved in securities distribution, including issuers, financial intermediaries, affiliated entities, and other factors.[145]

Debate persists regarding whether Section 17 independently authorises private legal claims.[146] Nevertheless, its broad provision establishes the

[143] Lucian A. Bebchuk, and Robert J. Jackson Jr., 'The Law and Economics of Blockholder Disclosure' (2012) 2 Harv. Bus. L. Rev 39, 49.

[144] 15 U.S. Code § 77q. *United States v. Naftalin*, 441 U.S. 768 (1979).

[145] Ibid.

[146] *Maldonado v. Dominguez*, 137 F.3d 1 (1st Cir. 1998).

statutory foundation for Rule 10b-5 under the Securities Exchange Act of 1934, as both provisions share the overarching goal of safeguarding investors by legally banning deceptive or manipulative conduct in securities transactions.[147]

2. Common Securities Causes of Action

In the U.S., civil litigation framework serves as a cornerstone of investor protection. This section evaluates investors' causes of actions and the functionality of such enforcement within capital markets, based on widely used legal frameworks for addressing investor loss.

2.1 An Overview of the Most Common Securities Causes of Action

This section will focus on the most common securities causes of actions rather than all possible causes of action. According to filing statistics, the securities cause of actions in legal practice primarily involves Sections 11 and 12 of the Securities Act of 1933, as well as Sections 10(b) and 14 of the Securities Exchange Act of 1934.[148] These statutory frameworks are comparatively prevalent in enabling plaintiffs to pursue remedies by aligning alleged misconduct with specific violations outlined in the provisions.

[147] A. A. Sommer Jr, 'Rule 10b-5: Notes for Legislation' (1965) 17 W. Res. L. Rev 1029, 1031.

[148] Cornerstone Research, *Securities Class Action Fillings 2023 Year in Review* (Cornerstone Research 2024) 1+15.

	Class Action Fillings	M&A Fillings that have Section 14 (Securities Exchange Act)	Class Action Fillings that have Section 11	Class Action Fillings that have Section 12(a)	Class Action Fillings that have Rule 10b-5
2023	215	7	17	21	196
2022	208	6	42	39	167
2021	218	18	28	12	182
2020	331	97	23	26	199
2019	427	160	27	187	232

Figure 1: Five-Year Overview of Securities Class Action Filing Trends in the U.S. (2019-2023)

Firstly, Sections 11 and 12 of the Securities Act of 1933 regulate the disclosure duties surrounding prospectuses and registration statements. When investors purchase securities based on prospectuses and registration statements, under Section 11, the issuer and other responsible parties are liable for false or misleading registration statements, irrespective of privity between the purchaser and the defendant.[149] In other words, regardless of who or where the investors obtain the securities from, Section 11 can potentially provide remedies.

In relation to Section 11, Section 12(a)(1) serves as a supplementary provision to ensure the accuracy of registered offering documents and holds the issuer accountable for unregistered securities that should have been registered.[150] A critical aspect of investor protection lies in Section 12(a)(2),

[149] Ernest L. Folk III, 'Civil Liabilities under the Federal Securities Acts: The Barchris Case Part I--Section 11 of the Securities Act of 1933' (1969) 55 Va. L. Rev 1, 10.

[150] 15 U.S. Code § 77l (a) (1).

which regulates securities transactions involving prospectuses or verbal disclosures. When such materials contain materially false statements or omit information, investors retain the right to file claims against the issuer under this provision. The distinctive nature of this provision will be discussed in Section 2.3.

Section 10(b) of the Securities Exchange Act of 1934 authorises the SEC to enact provisions to regulate manipulative or fraudulent conduct in securities markets. The SEC has issued a number of rules based on this authority,[151] the most important of which is Rule 10b-5. Among causes of actions, the current prominence of Rule 10b-5 as the cornerstone of private securities litigation is highlighted by legal practice.

Section 14 of the Securities Exchange Act of 1934 also operates as a critical legal basis for addressing securities-related disputes. Mirroring the interplay between Section 10(b) and Rule 10b-5, the SEC has enacted provisions under Section 14 to regulate specific market activities. For example, Sections 14(a) and (b) authorise the SEC to regulate proxy solicitations, with Rule 14a-9 explicitly banning materially false or misleading communications in such solicitations.[152] Separately, under

[151] Steve Thel, 'The Original Conception of Section 10 (b) of the Securities Exchange Act' (1990) 42(2) Stanford Law Review 385-464.

[152] 17 CFR 240.14a-9.

Section 14(e), Rule 14e-3 broadly restricts manipulative or deceptive tactics in merger and acquisition contexts, including illicit information sharing by those privy to tender offer details.[153]

	Section 11 Securities Act		Section 12(a)(2) Securities Act	Rule 10b-5 Securities Exchange Act	Section 14 Securities Exchange Act	
					Rule 14a-9	**Rule 14e-3**
Disclosure	Registration Statement		Prospectus or Oral Statement	Generally Misstatement in Secondary Market	Proxy Statement	Tender Offer
Persons Responsible	15 U.S. Code § 77k (a) & (b)		Securities Seller	Generally Any Person but See *Chiarella*	Solicitors of Proxy Statement	Any Person
	Issuer	Others				
Fault Standard	Strict Liability	Constructive Negligence	Constructive Negligence	Scienter	Negligence	Negligence
Reliance	Not Required	Not Required	Not Required	Fraud on the Market Theory	Essential Link	Objective Materiality
Defense	*Omnicare*	Due Diligent	Reasonable Care	*Ernst & Ernst v. Hochfelder*	-	-

Figure 2: Comparative Overview of the Key Elements of Common Securities Causes of Action

2.2 Strict Liability under Section 11 of the Securities Act

2.2.1 The Scope of Strict Liability of Issuers

Under the Securities Act of 1933, Section 11 mandates rigorous accuracy in documentation submitted within registration statements. In practice, plaintiffs frequently invoke Section 11 due to its relatively straightforward applicability. To prevail, plaintiffs must demonstrate material false statements or omissions within registration disclosure, and plaintiffs are exempt from

[153] 17 CFR § 240.14e-3.

proving direct reliance on misleading disclosures.[154] It should be noted that the provision's coverage can also extend to secondary market purchasers, provided they can "trace" the acquisition back to the misrepresentation during registration.[155] This "tracing requirement" necessitates showing that purchased securities were based on the flawed registration materials.

Potential defendants under Section 11 encompass not only issuers but also directors, underwriters involved in registration processes, corporate executives, and professional consultants contributing to disclosure documents.[156] It should be noted that non-issuer defendants may exert defences by demonstrating thorough due diligence efforts to verify statement accuracy, but issuers face strict liability for registration defects—no defence for *mens rea*.[157]

Under Section 11, plaintiffs pursuing claims shall satisfy the following core criteria: (1) Registration Compliance: The inaccurate disclosure must be formally registered.[158] (2) Material Inaccuracies: The inaccurate registration statements mislead investors. (3) Securities Acquisition: The plaintiff must have purchased the securities in question. (4) Demonstrable Damage: The

[154] 15 U.S. Code § 77k.

[155] *Kirkwood v. Taylor,* 590 F. Supp. 1375 (D. Minn. 1984).

[156] 15 U.S. Code § 77k (a) & (b).

[157] 15 U.S. Code § 77k. Ernest L. Folk III (1969), note 149, 10.

[158] *In re Airgate PCS, Inc. Securities Litigation*, 389 F. Supp. 2d 1360 (N.D. Ga. 2005).

economic loss is result from the false statement. If necessary, plaintiffs might also be required to establish: (5) Causal Linkage: A transaction causation between the purchased securities and the misrepresentation in the case where a trace requirement involved.[159]

Specifically, for issuers, the scope of this liability typically includes structured financial data, specifics about the issuance process, and occasionally interpretive assessments or forward-looking projections (but see PSLRA). However, legal disputes have arisen over whether subjective analyses or opinions in registration materials qualify as actionable misstatements under Section 11. The Supreme Court's *Omnicare* decision resolved this ambiguity, ruling that defendants may rebut claims related to such statements by demonstrating a reasonable basis for their assertions at the time of filing.[160]

In *Omnicare*, Omnicare was a pharmaceutical services provider. In 2005, a group of investors sued Omnicare, alleging that false statements existed in the registration violates Section 11. After the investors purchased Omnicare's stocks during the initial public offering. the SEC initiated a lawsuit against Omnicare, alleging kickback violations from pharmaceutical manufacturers.

[159] *Lee v. Ernst & Young, LLP*, 294 F.3d 969 (8th Cir. 2002).

[160] Michael Bitter, et al. 'The Impact of the Supreme Court's Omnicare Decision on Audited Financial Statement Disclosure' (2021) 22(1) Journal of Accounting, Ethics and Public Policy 1-26.

Thus, investors contended that Omnicare's registration filings contained misleading disclosures, the scrutiny of alleged kickback practices as evidence of material inaccuracies. In response, Omnicare argued that its statements were subjective interpretations rather than factual claims that were liable under Section 11. The company cited *Virginia Bankshares, Inc. v. Sandberg*, a court decision that states that legal compliance opinions are not covered by Section 11 unless they are supported by intentionally false or dishonest statements.[161]

Furthermore, the court ruled that if an issuer discloses evaluative opinion that it genuinely believes does not involve any issues of truthfulness, punishing the objective uncertainty would be contrary to the legislative purpose of imposing strict liability under Section 11. However, if these evaluative opinions were entirely excluded from the scope of Section 11, it would also substantially impact the reasonable investors' judgment of the financial condition. Therefore, the court held that concerning the application of opinion under Section 11, if investors can prove that Omnicare did not genuinely believe in the accuracy of the evaluation at the time of disclosure, Omnicare would still be subject to the liability under Section 11. That is, it

[161] *Virginia Bankshares, Inc v. Sandberg*, 501 U.S. 1083 (1991).

provides investors with an opportunity to demonstrate that Omnicare did not hold a sincere belief in the truthfulness of the disclosed information.[162]

2.2.2 Non-Issuer's Due Diligence Defence

Section 11 distinguishes between liabilities of issuers and non-issuers. Issuers have direct control over the overall information related to the offering due to their position.[163] Therefore, issuers have a better ability to fulfil the disclosure duty and ensure the accuracy of information.

Besides issuers, underwriters and accountants, as non-issuers, also participate in the preparation and disclosure of securities offerings. Compared to issuers, non-issuers do not possess the same level of role and control over information disclosure.[164] Therefore, Section 11 provides that non-issuers can defend against and avoid liability by proving they conducted a reasonable investigation, a concept often referred to as "due diligence."[165]

However, if we examine the text of Section 11, legislators did not specifically use the term "due diligence." Nonetheless, it still can be inferred that legislators intended to provide a remedy for non-issuers through

[162] *Omnicare, Inc. v. Laborers Dist*. Council Constr. Indus. Pension Fund - 135 S. Ct. 1318 (2015).

[163] Stephen Choi, 'Regulating investors not Issuers: A Market-Based Proposal' (2000) 88 Calif. L. Rev 279, 294-304.

[164] Ibid.

[165] 15 U.S. Code § 77k(b) & (c).

descriptions such as “reasonable investigation.”[166] This remedy ultimately encompasses and applies the concept of “due diligence.” In the application of the “due diligence” defence, legislators and courts have not provided a precise definition of “due diligence.” Instead, such a defence is subject to a “sliding scale of due diligence approach” in precedents.

The concept of the “sliding scale of due diligence approach” originated from the precedent of *Escott v. BarChris Constr. Corp*.[167] In *Escott*, the plaintiffs filed a lawsuit under Section 11, alleging false descriptions of assets in the registration statement of BarChris’s public offering. The plaintiff argued that, in addition to the issuer in this case, the signatories of the non-issuer’s registration statement, underwriters, and auditors should also bear the liability specified in Section 11. The court introduced the “sliding scale of due diligence approach” in its ruling on this case, and this principle states that the level of due diligence required for non-issuers varies depending on the specific circumstances of their involvement in securities offering.[168]

Finally, liability under Section 11 diverges from conventional negligence principles. To invoke a due diligence defence, defendants who rely on expert

[166] William K. Sjostrom Jr, ‘The Due Diligence Defense under Section 11 of the Securities Act of 1933’ (2005) 44 Brandeis LJ 549, 550

[167] *Escott v. BarChris Constr. Corp*., 283 F. Supp. 643 (S.D.N.Y. 1968).

[168] Eg *Weinberger v. Jackson*, 1990 WL 260676, 4 (N.D. Cal. Oct 11, 1990); *Herman MacLean v. Huddleston*, 459 U.S. 375, 103 S. Ct. 683 (1983); *Ernst & Ernst v Hochfelder* 425 US 185 (1976); *Monroe v. Hughes*, 31 F.3d 772, 774 (9th Cir. 1994).

advice must demonstrate both that they lacked reasonable grounds to suspect inaccuracies and genuinely believed the disclosures were truthful. That is, this standard contrasts with the "reasonable care" threshold typical of negligence claims.[169] Additionally, plaintiffs need not prove negligence by non-issuer defendants (e.g. underwriters or directors). Instead, once the plaintiff establishes the core elements under Section 11, the burden of proof directly shifts to non-issuers to absolve themselves by proving diligent efforts of verifying the contested statements. In effect, Section 11 imposes a constructive fault on non-issuers.[170]

2.3 Constructive Negligence under Section 12 (a)(2) of the Securities Act

2.3.1 The Scope of Section 12(a)(2)[171]

If material false statements or omissions exist in the prospectus, the person who purchases the securities can apply Section 12(a)(2) of Securities Act of 1933 against any person[172] who offers or solicits the transaction.[173] Like Section 11 claims, actions brought under Section 12(a)(2) relieve

[169] *John Nuveen Co. v. Sander*, 450 U.S. 1005, 1009 (1981).

[170] F A Gevurtz, 'United States: The Protection of Minority Investors and Compensation of Their Losses' in P-H Conac and Martin Gelter (eds) (2019), note 1, 119.

[171] 15 U.S. Code § 77l (a) (2).

[172] In a firm commitment underwriting, whether the issuer falls under Section 12(a)(2) is controversial. There are different views between 17 C.F.R. § 230.159A(a) and case law. *Baker v. SeaWorld Entm't, Inc.*, (2016) U.S. Dist Lexis 72409 [54].

[173] *Endo v. Albertine*, 147 F.R.D. 164, 172 (N.D. Ill. 1993).

plaintiffs of demonstrating either the defendant's fraudulent intent or their own reliance on misleading statements.

However, plaintiffs need to meet substantive elements, which are different from Section 11: The plaintiff acquires securities from the issuer, which indicates that two parties have privity in their legal relationship.[174] As a result, the remedy available under Section 12(a)(2) is distinct from that under Section 11. Based on the privity, Section 12(a)(2) permits a plaintiff to either rescind the securities transaction or seek damages if the securities were later sold to a third party. Therefore, to succeed on such a claim, the plaintiff must demonstrate: (1) a misstatement in the prospectus, (2) a direct transactional relationship (privity), and (3) causation and resulting damages, if rescissory damages are sought.[175]

In terms of the scope of Section 12(a)(2), it applies for investors in non-registration situations. Section 11 focuses on the responsibilities following from prospectus registration. Therefore, when the issuer chooses to issue securities through non-registration methods, investors cannot seek remedies under Section 11.[176] Controversial issues that arise in interpreting the scope

[174] *Shaw v. Digital Equip Corp.*, 82 F.3d 1194, 1220 (1st Cir. 1996). *Pinter v. Dahl*, 486 U.S. 622 (1988).

[175] *Junker v. Crory*, 650 F.2d 1349, 1362 (5th Cir. 1981).

[176] Hillary A. Sale, 'Disappearing without a Trace: Sections 11 and 12 (a)(2) of the 1933 Securities Act' (2000) 75 Wash. L. Rev 429. Non-public offerings, commonly referred to as private placements, are securities offerings exempt from registration with the SEC under provisions such as Regulation D of the Securities Act of 1933. These offerings are typically limited to accredited investors, such as high-net-worth individuals and institutional investors, or a small number of sophisticated purchasers, allowing issuers to bypass the rigorous disclosure and registration

of Section 12(a)(2) remain, such as whether Section 12(a)(2) is applicable to non-public offerings where Section 11 cannot apply. The courts have provided new interpretations of the Section 12(a)(2), making a substantial distinction for Section 12(a)(2).

In *Gustafson v. Alloyd Co.*, Gustafson, the sole owner of Alloyd, Inc., sold nearly all of the company's shares through a private sale. After the transaction, it became apparent that there was a significant discrepancy between the actual financial situation and the projected ones. The buyers then sought relief under Section 12(a)(2), aiming to rescind the deal.[177] However, the court ruled that Section 12(a)(2) was inapplicable to private sales like the one in question. It held that the provision pertains exclusively to public offerings, covering false statements made in a prospectus or similar communication related to the public distribution of securities by an issuer or a controlling shareholder. As such, it does not extend to private transactions.[178]

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requirements of public offerings. Private placements rely on exemptions like Regulation D (Rules 504, 505, and 506), permitting capital raising without SEC registration provided specific criteria are met, such as limiting sales to accredited investors, restricting resale, and avoiding general solicitation. Unlike public offerings, private placements target a narrow group of investors, which reduces regulatory burdens but also limits liquidity. Although the disclosure requirements are less stringent than those for public offerings, issuers must still provide sufficient information, often through a private placement memorandum (PPM), to avoid misleading investors.

[177] *Gustafson v. Alloyd Co.*, 513 U.S. 561, 115 S. CT. 1061 (1995).

[178] Andrew Downey Orrick, 'Non-Public Offerings of Corporate Securities-Limitations on the Exemption Under the Federal Securities Act' (1959) 21 University of Pittsburgh Law Review 1.

As the scope of Section 12(a)(2) has been interpreted to be limited to public offerings, it can be applied to securities issued by the issuer through a prospectus without formal registration, such as securities sold under Regulation A.[179] Contrarily, for issuers whose securities can qualify for complete exemption, such as Regulation D Rule 506 (private placement), Section 12(a)(2) cannot be used against issuers in a non-public offering based on a 2013 precedent.[180]

2.3.2 Reasonable Care Defence

Similar to the liability of non-issuers under Section 11, Section 12(a)(2) provides the issuer with defences. According to the provisions of Section 12(a)(2), an issuer can prove that they "did not know, and in the exercise of reasonable care could not have known, of such untruth or omission" to avoid liability.[181]

[179] Under Regulation A, issuers are not required to register with the U.S. Securities and Exchange Commission (SEC). Such offerings are also known as "mini-IPOs" or "Reg A+ offerings." It allows smaller companies to raise funds by selling securities to the public without going through the full registration process required for larger offerings. Companies seeking to conduct a Reg A offering must submit an offering statement to the SEC, which includes audited financial statements and other disclosures. The SEC reviews the offering statement and may request modifications or additional information before the offering can proceed. Once approved, the company can publicly offer and sell its securities to the public. <https://www.sec.gov/education/smallbusiness/exemptofferings/rega.> accessed 15 April 2025.

[180] *Brockton Retirement Board v. Oppenheimer Global Resource Private Equity Fund I*, LP 2013 WL 753310 (2013); Elliott J. Weiss, 'Securities Act Section 12(2) After *Gustafson v. Alloyd Co.*: What Questions Remain?' (1995) 50 The Business Lawyer 1209, 1221.

[181] *Davis v. Avco Financial Services, Inc.*, 739 F.2d 1057, 1068 (6th Cir. 1984).

According to case law, courts generally interpret the defence under Section 12(a)(2) as requiring a standard of reasonable care[182]—a threshold that is typically less stringent than the due diligence requirement under Section 11. However, the distinction between the two standards is not clearly defined in judicial decisions. In fact, some courts have treated the reasonable care standards under both Section 11 and Section 12(a)(2) as essentially the same,[183] while others have acknowledged slight differences but still regard them as closely aligned in substance.[184]

Lastly, in order to establish a prima facie case, the plaintiff does not have to show that the defendant acted in subjective bad faith. Therefore, a theory of constructive negligence serves as the effective foundation for liability under Section 12(a)(2).

2.4 Scienter under Rule 10b-5 of the Securities Exchange Act[185]

2.4.1 An Implied Cause of Action

Section 17 of the Securities Act of 1933 functions as a foundational anti-fraud statute, establishing the legal framework for Rule 10b-5.[186] The SEC

[182] *Royal American Managers, Inc. v. IRC Holding Corp.*, 885 F.2d 1011 (2d Cir. 1989).

[183] *John Nuveen Co. v. Sander* (1981), note 169.

[184] *Software Toolworks Securities Litigation*, 50 F.3d 615, 621 (9th Cir. 1994).

[185] 17 CFR § 240.10b-5.

[186] A. A. Sommer Jr (1965), note 147, 1031.

enacted Rule 10b-5 under Section 10(b), explicitly banning fraudulent misconduct.

This rule is broadly interpreted to address diverse securities misrepresentations,[187] and Rule 10b-5 remains one of the most frequently invoked legal grounds in U.S. securities litigation, particularly in class actions.[188] But unlike Sections 11 and 12 of the Securities Act of 1933, which primarily govern initial offerings, Rule 10b-5 predominantly applies to secondary market transactions.[189]

Rule 10b-5 was established to close gaps in combating securities misrepresentation within the secondary market.[190] Notably, like its statutory foundation in Section 10(b),[191] the provision does not expressly create causes of action statutorily, but in a historic 1946 ruling, courts acknowledged an implicit causes of action under both Section 10(b) and Rule 10b-5.[192] Despite serving as critical causes of action for securities private enforcement, neither the legislation nor the SEC offers a consistent framework for how to apply it

[187] Arthur M. Krawitz, 'Dirks, Defining the Scope of Rule 10b-5' (1983) 8 Del. J. Corp. L. 265-296.

[188] Amanda M. Rose, 'Reforming securities Litigation Reform: Restructuring the Relationship between Public and Private Enforcement of Rule 10b-5' (2008) 108 Columbia Law Review 1301, 1321.

[189] Peter H. Wemple, 'Rule 10b-5 Securities Fraud: Regulating the Application of the Fraud-on-the-Market Theory of Liability' (1984) 18 J. Marshall L. Rev 733, 745.

[190] American Bar Association, 'Conference on Codification of the Federal Securities Laws' (1967) 22 Bus Law 793-922.

[191] 15 U.S.C. § 78j.

[192] *Kardon v. Nat'l Gypsum Co.*, 69 F. Supp. 512 (E.D. Pa. 1946).

in courts.[193] As a result, the core interpretation for applying Section 10(b) and Rule 10b-5—including elements like materiality, scienter, and reliance—have been defined incrementally through decades of case law.[194]

2.4.2 State of Scienter

Courts have clarified through precedent that Rule 10b-5 liability requires proof of intentional deception (scienter) rather than mere negligence or breaches of fiduciary duty. This principle was solidified in *Ernst*. The case centred on investors who relied on audited financial statements from an accounting firm later found to contain material misrepresentations. In this case, the plaintiffs argued that Ernst & Ernst, as auditors, had a duty to ensure transparency in financial reporting, which means Ernst has to perform its service diligently. Since there are material misrepresentations, they filed suit under Section 10(b) and Rule 10b-5, alleging the firm's fraudulent conduct caused their financial losses. Based on the allegation, the court's decision emphasised that plaintiffs must demonstrate deliberate intent to deceive (scienter) as a *mens rea* element.[195]

Those decisions acknowledge that while the language of Rule 10b-5 could be read to strictly bar all material false statements or omissions, terms

[193] *Musick, Peeler & Garrett v. Employers Ins. of Wausau*, 508 U.S. 286, 292 (1993).

[194] *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 730 (1975); Marc I. Steinberg et al., *Securities Litigation: Law, Policy, and Practice* (Carolina Academic Press 2016) 190.

[195] *Ernst & Ernst v Hochfelder* (1976), note 168.

like "manipulative," "device," and "contrivance" in the provision's text signal Congress's aim to exclude negligence out of *mens rea*. Further, the term "manipulates" underscores this, as it implies intentional acts designed to distort market integrity. Thus, under Section 10(b) and Rule 10b-5, plaintiffs must prove both (1) fraudulent conduct (e.g. market manipulation) and (2) the defendant's subjective intent to defraud (scienter).[196]

Notably, while the Supreme Court in *Ernst* declined to rule on whether recklessness satisfies scienter, case law has since held that recklessness can trigger liability under Rule 10b-5.[197] Here, this recklessness standard calls for a deliberate disregard for evident risks, which reflects a lack of concern for the truthfulness of disclosures that reaches the level of quasi-intent, and it does not equate to gross negligence.[198]

Additionally, to prevent frivolous litigation, the PSLRA places a greater burden of proof on plaintiffs: the allegations must result in a "strong inference of scienter" (intent to deceive).[199] This standard was scrutinised in *Tellabs*, where the Supreme Court clarified how courts must evaluate scienter under the PSLRA. Here, the plaintiffs used the testimony of 27 secret witnesses who

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[196] Ibid.

[197] Eg *In re Silicon Graphics Inc. Securities Litigation*, 183 F.3d 970, 979 (9th Cir.1999).

[198] *Rolf v. Blyth, Eastman Dillon & Co.*, 570 F.2d 38 (2nd Cir. 1978).

[199] 15 U.S.C. § 78u-4 (b) (2).

were allegedly aware of internal company misconduct to prove scienter.[200] However, the Court decided that a scienter inference must be the most convincing explanation of the facts in order to meet the PSLRA. If other interpretations—like good-faith mistakes or innocent behaviour—are equally or more compelling, the alleged inference will not hold up, even if it is plausible. By ensuring that courts carefully consider whether plaintiffs' allegations of fraudulent intent outweigh other reasonable conclusions.[201]

2.4.3 Fraud on the Market Theory

For a Rule 10b-5 claim, plaintiffs must establish a key element: transaction causation (reliance).[202] However, requiring that each plaintiff directly relied on a specific misrepresentation is often unworkable, especially in large markets suffused with various disclosures of information. To address this challenge, courts adopted the fraud-on-the-market theory and created a presumption of reliance in efficient markets.[203] This argument lessens the burden of proof for plaintiffs in Rule 10b-5 claims by allowing them to meet

[200] *Tellabs Inc. v. Makor Issues & Rights*, 551 U.S. 308 (2007).

[201] In *Tellabs*, the Supreme Court introduced a "three-step process" to determine whether the plaintiff has sufficient facts to support a "strong inference." The court held that the inference should not be merely "plausible" or "reasonable," but it must be "cogent: and at least as compelling as any plausible inference contrary to non-fraudulent intent.

[202] J Goldberg and B Zipursky (2013), note 31, 1760.

[203] R. Douglas Martin, 'Basic Inc. v. Levinson: The Supreme Court's Analysis of Fraud on the Market and Its Impact on the Reliance Requirement of SEC Rule 10b-5' (1989) 78 Ky. LJ 403, 417.

the reliance requirement without demonstrating personal knowledge of the specific misrepresentations.[204]

Specifically, in *Basic*, a landmark case involving merger negotiations between Basic, Inc. and Combustion Engineering, the U.S. Supreme Court established precedent in favour of this theory. Although Combustion's tender offer was approved by the internal board, Basic publicly denied the merger negotiations. A class action lawsuit was filed by shareholders, led by Max Levinson, who claimed that Basic had misled them into selling shares at artificially low prices in violation of Section 10(b) and Rule 10b-5.[205] Here, the court, applying the efficient market hypothesis,[206] reasoned that investors in such markets inherently trust stock prices as accurate reflections of value, which presumes that they also believe in the disclosures that affect stock prices. This presumption alleviated plaintiffs' need to prove individual reliance on specific misrepresentations—a significant hurdle to apply such a cause of action. Besides, the ruling also simplified investors to set up a class by incorporating the fraud-on-the-market theory into procedural law,

[204] Ray R Singh, 'Fraud on the Market: Elements and Scope' (1990) 27 Bull. Bus. L. Sec. 9-36.

[205] *Basic Inc v. Levinson,* 485 U.S. 224 (1988).

[206] Burton G Malkiel, 'Efficient Market Hypothesis' in John Eatwell, Murray Milgate and Peter Newman (eds), *Finance* (Springer 1989) 127-134 <https://link.springer.com/chapter/10.1007/978-1-349-20213-3_13> accessed 15 April 2025.

allowing a class action to proceed in situations where direct proof of reliance would not be feasible otherwise.[207]

2.5 Negligence under Section 14 of the Securities Exchange Act

2.5.1 Duty of Care under Section 14(a) and Section 14(e)

The provision of Section 14(a) of the Securities Exchange Act of 1934 requires companies or solicitors of proxy statement[208] to provide shareholders with accurate information concerning matters on which shareholders are required to vote. Here, the legislative purpose of Section 14(a) is to ensure that shareholders receive adequate information before making decisions on significant matters concerning the exercise of their shareholder rights.[209] Notably, like many other provisions, Section 14(a) does not provide a specific statutory basis for establishing a cause of action. However, the court established the one regarding misrepresentation in proxy solicitations through *J.I. Case v. Borak*.[210]

Other than Section 14(a), Section 14(e) specifically targets fraudulent practices in tender offers.[211] The application of Sections 14(e) and Section

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[207] Daniel R. Fischel, 'Efficient Capital Markets the Crash and the Fraud on the Market Theory' (1988) 74 Cornell L. Rev 907, 908.

[208] Jeffrey J. Giguere, 'Negligence vs. Scienter: The Proper Standard of Liability for Violations of the Antifraud Provisions Regulating Tender Offers and Proxy Solicitations Under the Securities Exchange Act of 1934' (1984) 41 Wash. & Lee L. Rev 1045, 1046.

[209] 15 U.S. Code § 78n; 17 C.F.R § 2401.14a-9.

[210] *J.I. Case Co. v. Borak*, 377 U.S. 426 (1964).

[211] *Chiarella v. United States*, 445 U.S. 222 (1980).

10(b) has been controversial due to their textual similarities, but Section 14(e) has been interpreted to impose a duty of care on parties involved in tender offers, in contrast to the general anti-fraud scope of Section 10(b).[212] This distinction became critical in 1970 when Congress amended the Williams Act.[213] Here, legislative records, including Senate hearings, reveal Congress's intent to empower the SEC to prohibit trading based on undisclosed material information in tender offers. Senator Williams questioned the SEC about the functioning of Section 14(e) and Rule 14e-3 during these hearings. In essence, the SEC codified a duty to avoid from abusing non-public information by confirming that Rule 14e-3 would prohibit individuals who are aware of pending tender offers from trading without disclosure. The goal of Rule 14e-3 is to close regulatory gaps in tender offers by requiring transparency.[214]

2.5.2 Negligence

According to recent court rulings, plaintiffs who seek claims under Section 14(a) must show the defendant's negligence rather than scienter.[215]

In *Gould*, this principle was demonstrated when the defendant disclosed a proxy statement that contained material misrepresentations prior to a merger

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[212] *Schreiber v. Burlington Northern*, 472 U.S. 1 (1985).

[213] Public Law 90-439.

[214] Samuel N. Allen, 'The Scope of the Disclosure Duty under SEC Rule 14e-3' (1981) 38 Wash. & Lee L. Rev 1055-1074.

[215] *Dekalb Cnty. Pension Fund v. Transocean Ltd.*, 817 F.3d 393, 408 & n.90 (2d Cir. 2016).

vote. In this case, these statements falsely suggested shareholder consensus for the merger, omitted key details about certain shareholders' veto rights, and downplayed directors' conflicts of interest. Thus, based on the misrepresentation, plaintiffs sued under Section 14(a) and Rule 14a-9. The court ruled that consistent with legislative intent, these provisions are to ensure transparency in proxy solicitations, not to penalise deceptive intent. The court further reasoned that because Section 14(a) regulates specific statements made in the context of proxy solicitations, rather than deceptive conduct more broadly. Thus, imposing the scienter standard of Section 10(b) here would unfairly burden plaintiffs. Consequently, whether defendants failed to act with reasonable care—a negligence standard—better determines liability under Section 14(a).[216]

Similarly, Section 14(e), which addresses fraud in tender offers, was historically interpreted to require proof of scienter.[217] However, a 2018 case law recalibrated this view, holding that negligence suffices for liability under Section 14(e).[218] This shift aligns the liability thresholds for Rules 14a-9 (proxy statements) and 14e-3 (tender offers), creating a more consistent framework under Section 14.

[216] *Gould v. American Hawaiian Steamship Co.*, 535 F.2d 761 (3d Cir. 1976).

[217] Eg *In re Digit. Island Sec. Litig.*, 357 F.3d 322 (3rd Cir. 2004).

[218] *Varjabedian v. Emulex Corp.*, 888 F.3d 399 (9th Cir. 2018).

2.5.3 Presumptions of Reliance

Unlike the context under Section 14, case law indicates that plaintiff can prove indirect reliance through the "essential link" test.[219] The Supreme Court held that an essential link exists if there is a necessary connection between the proxy statement and the completion of the transaction.[220] In *Mills*, the company's management controlled 54% of the voting power, but the approval of the merger required a two-thirds vote of all voting shares. Therefore, for the merger transaction, it is essential to complete the specific acquisition through the proxy statement.[221]

Similarly, under Rule 14e-3, plaintiffs must similarly demonstrate reliance, showing their investment decisions were influenced by the defendant's fraudulent conduct. Then plaintiffs could proceed to establish that the alleged misconduct later directly caused their financial losses. However, proving subjective reliance may impose an impossible burden of proof.[222] Therefore, the court holds that reliance on the defendant's misconduct can be established through "objective materiality."[223] In other words, when the defendant engages in transactions based on material non-public information,

[219] E. L. Smith, 'Securities Regulation--Shareholder Derivative Suits Under Rule 14a-9' (1970) 49 NCL Rev 215, 217.

[220] *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970).

[221] Ibid.

[222] *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-54 (1972).

[223] Ibid.

plaintiffs may be deemed to have relied on the integrity of the tender offer process. As a result, the element of "reliance" can be presumed.[224]

2.6 Summary

U.S. securities law, especially private enforcement, empowers investors to pursue civil remedies through litigation based on various causes of action, to recover losses caused by misconduct.

Firstly, key pillars of this framework are the liability regimes under Sections 11 and 12 of the Securities Act of 1933, which specifically regulates public offerings. Unlike other provisions requiring proof of intent, these Sections hold issuers, underwriters, and other offering participants automatically liable for material misstatements or omissions in offering statements. Public offering statements are intended for widespread dissemination, and investors in public offerings cannot readily assess every detail for accuracy on their own. Thus, for this reason, these Sections ensure robust investor protection in public markets by eliminating/shifting the burden of proof.

Here, strict liability ensures that issuers remain fully accountable for any material misrepresentations in those statements even in the absence of fault.

[224] Karen A. Tallman, 'Private Causes of Action Under SEC Rule 14e-3' (1982) 51 Geo. Wash. L. Rev 290, 305.

This high-level protection underpins market confidence and promotes efficient capital markets by assuring investors that they will be compensated if they rely on misleading disclosures, while still preserving investor freedom to buy and sell securities without undertaking costly independent investigations.

The other feature is the concept of constructive fault, which further simplifies the litigation for investors. Constructive fault under Section 11 and Section 12 allows investors to bypass the procedural burden to prove that parties, such as underwriters or corporate officers, acted in bad faith when a material misrepresentation occurs. In securities litigation, proving an individual's state of mind can be a complex and challenging task, especially when dealing with internal company staffs. Thus, constructive fault alleviates this challenge by allowing investors to hold responsible parties liable without proving that they knowingly engaged in misrepresentation.

Second, although secondary-market transactions and proxy-statement disclosures fall outside the strict/constructive fault liability regime, further case law under Rule 10b-5 strikes a balance between investor protection and issuers' compliance cost. In those settings, investors typically must demonstrate *mens rea*. This division based on state of mind shows that while these causes of action generally favour investor protection, it also considers the economic implications (compliance cost) for defendants.

For example, if all causes of action applied strict liability, the cost of disclosure for issuers would increase substantially. This heightened compliance cost could deter issuers from participating in the securities market, ultimately undermining the economic function of these markets. Therefore, these causes of action differentiate between various states of mind, ranging from strict liability, constructive fault, negligence to scienter, depending not only on the state of the market but also on the nature of the misrepresentation.[225] For general misrepresentations (more cost of compliance), such as those covered by Rule 10b-5, a higher burden of proof for plaintiff is required, including demonstrating scienter. In contrast, specific misrepresentations (less cost of compliance) under Sections 14, which involves proxy statements and tender offers, require a showing of negligence. Thus, this nuanced approach balances the need to protect investors with the need to maintain economic efficiency for issuers.[226]

Thirdly, another significant feature is the eased requirement for proving reliance compared with common law. Reliance is a fundamental element of misrepresentation claims, as plaintiffs must demonstrate that they relied on a misrepresentation that caused their loss. However, in securities

[225] Guido Calabresi and Jon T. Hirschoff, 'Toward a Test for Strict Liability in Torts' (1972) 81(6) The Yale Law Journal 1055, 1074.

[226] Eg Frank Partnoy, 'Barbarians at the Gatekeepers: A Proposal for a Modified Strict Liability Regime' (2001) 79 Wash. ULQ 491, 493.

misrepresentation, reliance is often more difficult to prove due to the complexity of market dynamics and the nature of investment decisions.

Section 11 and Section 12 both eliminate the need for investors to prove reliance altogether, making it much easier for them to bring claims. Further, under Rule 10b-5, the reliance element can be constructed through the fraud-on-the-market theory. Based on the theory, if market prices in efficient markets are distorted, plaintiffs are therefore exempt from having to demonstrate a reliance on misrepresentation. Similarly, for claims under Section 14 (governing proxy solicitations and tender offers), courts do not demand proof of common law reliance (direct and subjective). Instead, plaintiffs may show the misstatement or omission was an “essential link” in the transaction. This requires demonstrating that the misrepresentation was a materially significant factor influencing the shareholder’s voting or investment decision, thereby establishing a causal connection (reliance).

In conclusion, the major causes of action under U.S. securities law are carefully designed to facilitate investor litigation by reducing the evidentiary burdens typically associated with proving misrepresentation. Through mechanisms like strict liability, constructive fault, and eased reliance requirements, these causes of action make it easier for investors to seek redress for damage suffered. Meanwhile, what cannot be ignored is that these causes of action carefully balance these investor protections with considerations of economic efficiency, ensuring that the securities market can economically function with a fair level of compliance burden for defendants.

3. Class Actions: Quality Control and Volume Management

This Section will examine the procedural factors that bolster the application of causes of action in Section 2. In practice, investors often rely on class actions because pursuing individual lawsuits can be prohibitively expensive and complex, effectively deterring many from seeking redress even when harmed by issuer misconduct. In the U.S., procedural factors not only lower the financial and procedural barriers to entry (e.g. certification) but also enhance the feasibility of securities litigation as a viable option for addressing misconduct in the market. Eventually, "U.S. Class Action" provides a powerful legal resort for collective redress, allowing investors to pool resources, share litigation costs, and efficiently pursue claims that might be impractical to litigate individually.

3.1 Certification

The dominance of federal law, like the SLUSA, limits state class actions for most and common securities fraud claims. Thus, although there are state and federal class action cases, the one covered in this Section is exclusively relevant to federal securities litigation, which is predominantly governed by the Federal Rules of Civil Procedure (FRCP).

To initiate a class action, plaintiffs must first secure a class certification order from the court, and then the group of plaintiffs can be officially recognised as a collective litigation entity by this order. Two sets of conditions must be met in order to receive certification: (1) The prerequisites of Rule 23(a) are Numerosity, Commonality, Typicality and Adequacy of Representation. (2) Rule 23(b) categories: demonstrating eligibility for class setup through the Predominance and Superiority tests.

3.1.1 Four Prerequisites under FRCP Rule 23 (a)

A class action begins when a named plaintiff files a complaint, initiating a legal process governed by Rule 23(a) of the FRCP. This rule focuses on two key relationships: those among all class members and those between the representative and the class, ensuring that collective litigation is both practical and fair. It establishes four prerequisites for certifying a class, which are Numerosity, Commonality, Typicality, and Adequate Representation.

The first prerequisite, numerosity, requires that the class size be sufficiently large to render individual lawsuits unfeasible. While there is no fixed numerical threshold,[227] courts generally require at least 40 members.[228] The Supreme Court has clarified that numerosity cannot be assumed in general, and courts must analyse the likely size of a proposed class based on case-specific evidence rather than relying on speculative assumptions about membership numbers.[229] Notably, although plaintiffs need not identify every class member to prove numerosity,[230] courts have strict requirements to prevent the abuse of class actions,[231] requiring evidence that has "real teeth and real bite" to guarantee that the class is actually large.[232] This phrase emphasises that speculative or imprecise estimates are inadequate; the inference of a sufficiently large group must be supported by reliable evidence.

Commonality, the second requirement, focuses on shared legal or factual issues among class members.[233] It does not require uniformity in all claims but demands at least one central question whose resolution will advance the litigation for the entire class.[234] Specifically, for members, regardless of how many legal issues stem from a common fact, the Commonality requirement is satisfied if there is a shared legal or factual issue, as long as the class action

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[227] *In re Am. Med. Sys., Inc.*, 75 F.3d 1069, 1079 (6th Cir. 1996).

[228] *Ansoumana v. Gristede's Operating Corp*., 201 F.R.D. 81, 85 (S.D.N.Y. 2001).

[229] *General Telephone Co. v. EEOC*, 100 S.Ct. 1695, 1706 (1980).

[230] *Charrons v. Pinnacle Grp. NY LLC*, 269 F.R.D. 221, 230 (S.D.N.Y. 2010).

[231] *Marcus v. BMW of N. Am., LLC*, 687 F.3d 583, 595 (3rd Cir. 2012).

[232] *Allen v. Ollie's Bargain Outlet, Inc.*, No. 21-2121 (3d Cir. 2022).

[233] *In re Am. Med. Sys., Inc.* (1996), note 227.

[234] *Stinson v. City of N.Y.*, 282 F.R.D. 360, 369 (S.D.N.Y. 2012).

presents a shared answer to that common legal or factual issue.[235] Besides, courts evaluate the reliability of evidence demonstrating commonality,[236] but they only consider matters that are directly related to the shared question.[237]

Thirdly, the typicality requirement ensures that the class representative's assertions or defences closely mirror those of the class members they are attempting to represent, which avoids conflicts of interest and guarantees coherent advocacy. Unlike commonality, which examines class-wide issues, typicality relates to the relationship between the representative and absent members.[238] The representative's claims must arise from the same factual and legal grounds as those of the class.[239] If the representative relies on a unique defence—such as a contractual clause applicable only to them—typicality may fail, as this could create conflicts or divert focus from the class's core issues.[240] It should be noted that since the requirement concerns liability rather than individualised damage, differences in the amount or kind of damages among members are not grounds for typicality.[241]

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235 *In re Scotts EZ Seed Litig.*, 304 F.R.D. 397, 405 (S.D.N.Y. 2015).

236 *Sykes v. Mel S. Harris & Assocs. LLC*, 780 F.3d 70, 85 (2d Cir. 2015).

237 *Mazza v. American Honda Motor Co.*, Inc., 666 F.3d 581, 588-89 (9th Cir. 2012).

238 *Sprague v. General Motors Corp.*, 133 F.3d 388, 399 (6th Cir. 1998).

239 *Robinson v. Metro-North Commuter R.R.*, 267 F.3d 147, 155 (2d Cir. 2001).

240 *Ellis v. Costco Wholesale Corp.*, 657 F.3d 970, 984-85. (9th Cir. 2011).

241 *Duprey v. Conn. Dep't of Motor Vehicles*, 191 F.R.D. 329, 337 (D. Conn. 2000).

Last but not least, adequate representation ensures that the representative plaintiff and their lawyers can fairly defend the interests of each class member.[242] To do this, the representative must stay clear of any conflicts of interest that might compromise their capacity to speak up for the class.[243] Given that lawyers frequently direct litigation strategy, courts carefully consider the representative's intentions as well as the class counsel's expertise.[244] Specifically, counsel's qualifications are covered separately in Rule 23(g), which requires the court to examine whether those lawyers have the resources and experience necessary to handle the case successfully.[245]

Together, these requirements balance efficiency with fairness, allowing courts to resolve widespread disputes while safeguarding individual rights.

3.1.2 Predominance and Superiority under FRCP Rule 23 (b) (3)[246]

In general, when the prerequisites of Rule 23(a) are satisfied, securities class actions typically proceed under the framework of Rule 23(b)(3). Rule

[242] *Maywalt v. Parker & Parsley Petroleum Co*., 67 F.3d 1072, 1077-78 (2d Cir. 1995).

[243] *Stout v. J.D. Byrider*, 228 F.3d 709, 717 (6th Cir. 2000).

[244] *Kurtz v. Kimberly-Clark Corp.*, 321 F.R.D. 482, 535-36 (E.D.N.Y. 2017).

[245] *Gomez v. St. Vincent Health, Inc.*, 649 F.3d 583, 591-93 (7th Cir. 2011).

[246] If a class action meets the prerequisites of Rule 23(a) of the FRCP, the court must determine the appropriate type of Class Action based on Rule 23(b). Rule 23(b) outlines three categories of class actions: Rule 23(b)(1) falls under Mandatory Class Action. In this category, there is no need to provide the members of the class action with the right to opt-out. This type primarily applies when the defendant has a legal duty to treat all potential members equally, and the absence of a member would harm their interests. Rule 23(b)(2) class actions address cases where the plaintiffs seek to alter or prohibit a specific action by the defendant rather than seeking monetary compensation through litigation. Similar to Rule 23(b)(1), potential plaintiffs do not have the right to opt-out. It is a form of mandatory class action. Arthur R Miller, 'An Overview of Federal Class Actions: Past, Present and Future' (1978) 4(2) The Justice System Journal 197-220.

23(b)(3) requires that this securities litigation must pass the dual test of Predominance and Superiority.

The term "Predominance" refers to the requirement that the common legal or factual issues among the members should outweigh the differences.[247] Its purpose is to determine whether the class action exhibits sufficient cohesiveness to ensure the progress of the litigation.[248]

Specifically, the court undertakes a "close look" examination to assess whether the class action meets the Predominance requirement.[249] This examination serves as an initial mock trial for the contested issues.[250] The court bears the responsibility to conduct this analysis. If it determines that the plaintiffs' legal claims lack applicability across the proposed class, or if the defendant demonstrates that individualised defences apply to certain members, the court may find that the predominance requirement of Rule 23(b)(3) is not met, thereby precluding class certification.[251] It is important to note that failing to meet Predominance does not necessarily mean the class action will be terminated. Instead, for these individual issues, the court can

[247] Stephen R. Bough and Andrea G. Bough, 'Conflict of Laws and Multi-State Class Actions: How Variations in State Law Affect the Predominance Requirement of Rule 23(b)(3)' (1999) 68 UMKC L. Rev 1, 12.

[248] *Amchem Prods, Inc. v. Windsor,* 521 U.S. 591, 617 (1997).

[249] *Comcast Corp. v. Behrend*, 569 U.S. 27 (2013).

[250] *Butler v. Sears, Roebuck & Co.*, 727 F.3d 796, 801 (7th Cir. 2013).

[251] *Marcus v. BMW of N. Am., LLC* (2012), note 232.

opt to handle the members' problems using subclasses.[252] Unlike the Commonality requirement of Rule 23(a), Predominance involves a substantial examination of common legal or factual issues to a certain degree, whereas the former is more of a formal examination.[253] Similarly to Rule 23(a), Predominance is not determinative. In other words, a class action doesn't need every issue involved to satisfy commonality to meet the Predominance requirement. If one key issue meets the Predominance requirement, the class action can satisfy the requirement of Predominance.[254]

Additionally, the requirement of Superiority demands proving that the class action lawsuit is more effective and impartial than alternative legal resorts.[255] In practice, the court initially considers factors such as the individual benefits obtained in individual litigation versus those in the class action, the existence of individual lawsuits, the desirability of collective litigation, and the manageability of the class action.[256]

Specifically, Superiority encompasses, but is not limited to, the consideration of these factors.[257] Although these factors are non-exhaustive,

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[252] *Manual for Complex Litigation* (4th ed.) ("MCL") § 21.23.

[253] *In re Orthopedic Bone Screw Prods. Liab. Litig.,* 176 F.R.D. 158, 174 (E.D. Pa. 1997).

[254] *In re Ford Motor Co. Ignition Switch Prod. Liability Litigation*, 174 F.R.D. 332, 348 (D.N.J. 1997).

[255] Jon Romberg, 'Half a Loaf Is Predominant and Superior to None: Class Certification of Particular Issues Under Rule 23(c)(4)(A)' (2002) 249 Utah L. Rev 249, 255.

[256] Rule 23(b)(3) (A-D)

[257] *Brown v. Cameron-Brown Co.*, 92 F.R.D. 32, 49 (E.D. Va. 1981).

Superiority can be broadly categorised into legal superiority and class superiority. From the legal perspective, factors influencing the superiority determination include the benefits members gain from different legal resorts, the potential for different choice of law issues, and the reasonable protection of members' right to opt out. Besides, in terms of class superiority, courts also assess whether the jurisdiction has an appropriate forum for the case and whether the class action has a reasonable and feasible trial plan are also relevant considerations. Notably, the superiority requirement under Rule 23(b)(3) does not assign predetermined weight to its factors; satisfaction hinges on a fact-specific analysis of the class action's context, requiring judicial assessment of whether collective litigation is more efficient than individual suits.[258]

3.2 Opt-out

3.2.1 Opt-out v. Opt-in

Under FRCP Rule 23(b)(3), class action members have the ability to opt out—a mechanism that helps maintain the size of the class, and are entitled to notification. Here, courts are required to make sure notice is sent to every identifiable class member. By a deadline set by the court, recipients have the

[258] Andrea Joy Parker 'Dare to Compare: Determining What Other Available Methods Can Be Considered under Federal Rule 23(b)(3)'s Superiority Requirement' (2009) 44 Ga. L. Rev 581, 588.

option to opt out, or exclude themselves;[259] if they don't, they forfeit their individual claims and are bound by the decision of the lawsuit. This Opting out protects also the right to bring separate legal action.[260] At crucial points, like proposed settlements or dismissals, courts may also demand renewed opt-out notifications in order to confirm members' consent.[261]

In contrast, an opt-in regime requires affirmative actions to be taken in order to participate in the class, like formally joining or submitting documentation. This shields investors from being forced to participate, but it also runs the risk of underparticipation because of oversight or inaction.[262]

The fundamental distinction between opt-out and opt-in systems turns on presumed inclusion: (a) Opt-out: All eligible individuals are automatically bound to the class action unless they take affirmative steps to exclude themselves. (b) Opt-in: Individuals are not included unless they actively choose to opt in. Specifically, opt-out systems tend to aggregate a larger number of class members since they capture all potential plaintiffs by default. This can lead to a more substantial and representative class, enhancing the collective bargaining power and increasing the likelihood of a favourable

[259] Fed. R. Civ. P. 23(c)(2)(B)(v).

[260] *Amchem Prods, Inc. v. Windsor* (1997), note 248.

[261] Fed. R. Civ. P. 23(e).

[262] Eg Lennarts, Loes, and Joti Roest,'Netherlands: Protection of Investors and the Compensation of Their Losses' in Pierre-Henri Conac and Martin Gelter (eds) (2019), note 1, 469; Pedro Domingues, 'Portugal: The Legal Framework of the Portuguese Capital Market' in Pierre-Henri Conac and Martin Gelter (eds) (2019), note 1, 537.

outcome for the class. On the other hand, because only those who actively participate are included, opt-in systems might lead to smaller class sizes, which could reduce the class's overall power.

The opt-out system is a more successful strategy because it provides investors with a number of benefits.

Firstly, the opt-out system automatically includes all affected investors in the class action unless they choose to withdraw. It promotes comprehensive representation of investor interests by fostering a litigation framework that efficiently aggregates claims and boosts collective bargaining power. By involving a greater number of harmed parties, the system raises the likelihood of obtaining larger recoveries—whether through settlements or judgments—that reflect the full range of damages.[263]

Second, in the opt-in system, investors must actively decide to participate. This requirement places a burden on individuals to stay informed and take action. Thus, many investors may miss out on the opportunity to join the class due to inertia or lack of awareness.[264] In contrast, the opt-out system mitigates this risk by including all potential class members by default, ensuring that

[263] John Bronsteen, 'Class Action Settlements: An Opt-In Proposal' (2005) 903 U. ILL. L. Rev 906, 911.

[264] Edward H. Cooper, 'The (Cloudy) Future of Class Actions' (1998) 40 ARIZ. L. Rev 923, 907. It is not comprehensible to most people since most of notices are written in legal jargon; Thomas E. Willging et.al, 'An Empirical Analysis of Rule 23 to Address the Rulemaking Challenges' (1996) 71 N.Y.U.L.Rev 74, 134-137.

investors who are unaware of the action or who fail to act in time are still represented.

Thirdly, other than having a larger number of members and the potential for greater damages, a class action enjoys stronger negotiating power due to its consolidated resources. When faced with a substantial collective financial capacity, defendants are more likely to lose their advantage in financial leverage, increasing the likelihood that they will settle or confront significant legal challenges in defending against a comprehensive class of investors. The opt-out system helps to consolidate the claims of a larger group, making it more difficult for defendants to undermine the collective litigation.[265]

While both opt-out and opt-in class actions have distinct strengths, the opt-out framework typically provides greater benefits for investors. By automatically including all eligible participants and minimising individual participation burdens, this system ensures holistic advocacy for investor interests. It mitigates the risk of inadvertent exclusion and bolsters the collective's leverage in negotiations, facilitating powerful resolutions that reflect the full scope of damage.

[265] Bruce I. Bertelsen et al., 'Note, The Rule 23(b)(3) Class Action: An Empirical Study' (1974) 62 GEo. L.J. 1123, 1150.

3.2.2 The Constitutional Limitation on Opt-out in the U.S. Class Action

However, it cannot be conclusively maintained that the opt-out mechanism constitutes an ideal or flawless procedural device, as the boundless size of a class action may jeopardise potential plaintiffs who have individual causes of action to pursue. Therefore, the application of the class action is constrained by the Due Process Clauses in the Fifth and Fourteenth Amendments of the U.S. Constitution. Because class membership entails the forfeiture of individual litigation rights, concerns arise that such forfeiture could undermine their right of due process. Thus, the application of the class action must be carefully limited to balance collective efficiency and individual autonomy in legal proceedings.

Firstly, the res judicata of judicial decisions cannot be arbitrarily expanded. The res judicata devised in class actions is not a general rule.[266] If the interests of one party's litigants were not adequately represented in prior litigation, then as parties not previously bound by the court's judgment, they should not be constitutionally bound by that previous judicial decision.[267]

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[266] Steven TO. Cottreau, 'The Due Process Right to Opt Out of Class Actions' (1998) 73 NYUL Rev 480, 486.

[267] *Hansberry v. Lee*, 311 U.S. 32 (1940).

Second, the expansion of res judicata must meet reasonable procedures. *Phillips Petroleum* ruled that to satisfy individual litigation interests, the court needed to correctly assert personal jurisdiction, thereby determining the scope of res judicata's applicability.[268] In the absence of a determined reasonable scope for res judicata, potential plaintiffs would be unable to exercise their rights, thereby violating the due process requirement.[269]

Thirdly, when opt-out procedures proceed, courts must adhere to the "best notice" standard. This involves two primary responsibilities for courts: (1) Method of Notice: Courts must give actual notice by direct means, such as mail, email, or other focused communications designed to efficiently reach recipients.[270] (2) Content Requirements: Notices must include the following information and be written in plain language: a brief synopsis of the facts, allegations, and defences in the case; a thorough explanation of the class members' rights, including when they can choose to leave and the consequences of remaining in the class.[271] With these, the "best notice" could ensure that individuals are fully informed to make autonomous decisions about participation, balancing judicial efficiency with constitutional protections against involuntary waiver of legal rights.

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[268] *Phillips Petroleum Co v. Shutts*, 472 U.S. 797, 812 (1985).

[269] Ibid [806-814].

[270] Fed. R. Civ. P. 23(c)(2)(B).

[271] Ibid.

Controversially, the rules involving the "best notice" do not specify a precise timeframe for exercising the opt-out right, and an inappropriate timeframe could potentially infringe upon the constitutional rights of plaintiffs. Notably, current case law provides an interpretation for a reasonable opt-out timeframe, suggesting that the court should provide a window of 30 to 90 days to ensure the protection of potential plaintiffs' constitutional interests.[272] However, this window is not binding, which means a timeframe outside the range of 30 to 90 days doesn't necessarily render the procedure unconstitutional. Rather, it requires a case-specific evaluation to make a more appropriate determination. For example, it must assess both the method of notice and the characteristics of potential plaintiffs. For instance, if a class action involves a large and dispersed group of plaintiffs across multiple states, relying on inadequate notice methods (such as local newspapers) with a window of 30-day may fail to satisfy due process requirements.[273]

3.3 Other Facilitative Institutions in Strengthening Private Enforcement

In addition to the system's clear procedural rules, simple certification, and opt-out mechanism, the U.S.' widespread use of securities class actions

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[272] Federal Judicial Center, *Judges' Class Action Notice and Claims Process Checklist and Plain Language Guide* (2010) 4.

[273] Alexander W. Aiken, 'Class Action Notice in the Digital Age' (2016) 165 U. Pa. L. Rev 967, 981.

is a result of the interaction of statutory securities protections, litigation cost dynamics, and financial incentives for both plaintiffs and lawyers.

3.3.1 Reliance Presumptions Facilitate Securities Class Litigation

In class actions, the successful establishment of the substantive legal requirement of reliance for class members will determine whether successful class certification is possible.[274] In U.S. securities law, Section 2.6 has discussed how the court has provided presumptions in favour of reliance, such as fraud-on-the-market theory, to assist plaintiffs in establishing reliance. Here, the general structure of securities litigation may be significantly impacted by changing the degree of difficulty in demonstrating reliance. Therefore, changes to the burden of proof for reliance would significantly impact prospects for bringing securities class actions.[275]

In *Basic*, the court faced a procedural issue. It believed that if each class member needed to prove the establishment of reliance individually—meaning each person had to prove obtaining and acting upon false information—then the cumulative burden of addressing all these individual issues in a single trial would render class action inappropriate. As mentioned earlier, the FRCP requires Predominance, a requirement that can lead to a multitude of proof

[274] Sheila B. Scheuerman, 'The Consumer Fraud Class Action: Reining in Abuse by Requiring Plaintiffs to Allege Reliance as an Essential Element' (2006) 43 Harv. J. on Legis. 1, 20.

[275] Geoffrey Miller, 'The Problem of Reliance in Securities Fraud Class Actions' (2015) 57 ARIZ. L. Rev 61, 62.

issues involving false statements, materiality, fraudulent intent in securities claims, and causation. Comparatively, the elements of material misrepresentation and *mens rea* are commonly shared. Accordingly, in certifying a class action, once the court applies the presumption of transactional causation—known as the fraud-on-the-market theory—it becomes considerably easier to satisfy the certification requirements under the FRCP.[276]

Furthermore, class certification does not require a showing of substantial reliance; rather, it necessitates only a formal presumption of reliance. In *Amgen*, defendants contended that materiality should be evaluated during class certification. They argued that plaintiffs must prove materiality in order to justify reliance on this presumption.[277] However, the court disagreed, holding that materiality relates to the claim's merits rather than class certification. The ruling reduced the burden on plaintiffs at the certification stage by separating procedural certification from substantive legal issues.

3.3.2 Cost Shifting Rule

The allocation of litigation costs resulting from a lawsuit is also a determining factor for ease of conducting litigation. When plaintiffs file or

[276] *Basic*, note 205.

[277] *Amgen, Inc. v. Connecticut Retirement Plans and Trust Funds*, (2013) 133 S. Ct. 1184

participate in a lawsuit, they consider the likelihood of the lawsuit's success. From a risk-avoidance perspective, the rules governing the allocation of costs can either discourage or incentivise plaintiffs to initiate lawsuits.[278] Furthermore, the costs of litigation and the requirement of upfront fees can potentially deter the initiation of lawsuits.[279]

The "Loser Pays" rule, which states that the losing party must pay the winning side's legal bills, was initially upheld by the U.S. judicial system, but the Supreme Court abolished this default practice through precedent.[280] In contrast, in the U.S., securities class actions follow the "American Rule," which stipulates that each party must pay its own legal fees regardless of the outcome.[281]

This distinction matters because in securities cases, individual plaintiffs usually recover only small amounts, even though the total class payout may be large. This imbalance discourages private lawsuits. Thus, imposing a "Loser Pays" regime here would exacerbate this disincentive, as risk-averse plaintiffs—often with limited resources—would face prohibitive financial

[278] K. Spier, 'Litigation' in A.M. Polinsky and S. Shavell, *Handbook of Law and Economics* (Volume 1 Elsevier 2007) 259.

[279] M. Gelter, 'Mapping Types of Shareholder Lawsuits across Jurisdictions' in Sean Griffith, Jessica Erickson, David H Webber and Verity Winship (eds), *Research Handbook on Representative Shareholder Litigation* (Edward Elgar Publishing 2018) 459-481.

[280] *Arcambel v. Wiseman*, 3 U.S. (3 Dall.) 306 (1796).

[281] David A. Root, 'Attorney Fee-Shifting in America: Comparing, Contrasting, and Combining the American Rule and English Rule' (2005) 15 Ind Int'l & Comp L Rev 583, 584-586.

risk if they lost. By insulating plaintiffs from defendant's legal fees, the U.S. system lowers barriers to initiating securities claims.

It could be deemed that plaintiffs' propensity to litigate is increased by this cost structure and class action processes that combine modest claims, which helps explain why securities class actions are so common. Thus, the absence of fee-shifting in this context reinforces access to justice while balancing deterrence of meritless suits.

3.3.3. Entrepreneurial Incentives

3.3.3.1 Contingency Fee Agreement

Research indicates that in the U.S., entrepreneurial incentives are considered one of the primary reasons for numerous securities class action cases. Among these incentives, the Contingency Fee Agreement is a key component of entrepreneurial incentives.[282]

A Contingency Fee Agreement is a pre-litigation contract between a client and their attorney that defines compensation terms based on case outcomes. Its defining feature is the "no recovery, no fee" principle: If the plaintiff secures no monetary award or settlement in the securities class action, they owe nothing to their attorney—no legal fees and no litigation expenses

[282] J. C. Coffee Jr, 'Rescuing the Private Attorney General: Why the Model of the Lawyer as Bounty Hunter is Not Working' (1983) 42 Md. L. Rev 215, 239.

(Eg filing fees, expert witness costs). Thus, under this arrangement, the attorney assumes the financial risk of litigation. This arrangement allows plaintiffs who lack the funds to pay for litigation up front to access justice while balancing the lawyer's incentives with the client's desire to succeed.[283]

Unlike traditional hourly billing (consultancy fee), traditional contingency fee agreements in securities class actions calculate attorney fees as an agreed-upon percentage of the plaintiff's financial recovery (Eg settlement or court-awarded damages). Here, individual investors may face the challenge of high litigation costs when pursuing lawsuits individually. This is because single investors might find it difficult to afford substantial legal fees, particularly in cases involving large-scale collective damages. Therefore, if attorneys were limited to traditional hourly billing methods for initiating securities class action lawsuits, they would need to invest more effort into identifying eligible plaintiffs willing to pay legal fees. This would indirectly raise the cost of initiating such lawsuits. Additionally, under the calculation method of contingency fee agreements, attorneys have the incentive to increase the amount of compensation sought in the lawsuit. This

[283] Samuel R. Gross , 'We Could Pass a Law... What Might Happen if Contingent Legal Fees Were Banned' (1997) 47 DePaul L. Rev 321, 345.

is because higher damages translate to higher attorney fees, to some extent boosting attorneys' enthusiasm for handling securities litigation cases.[284]

3.3.3.2 Settlement

Due to the potential for financial and reputational damages in securities class action, both attorneys and plaintiffs may find themselves in a deterrently advantageous position during the litigation and settlement negotiation processes.[285] As a result, in judicial practice, a great number of securities class actions are often resolved through settlements.[286] Similar to the damages awarded in securities litigation cases, contingent fee agreements can also be based on the settlement amount reached. Attorneys receive compensation from the settlement award based on a certain percentage. This significantly incentivises attorneys to opt for the litigation strategy of settlement, which tends to be quicker and less time-consuming.

Under the doctrine of res judicata principles, class action settlement agreements are legally binding and prohibit further claims on the same matters. Courts review proposed settlements to make sure they are fair for all class members. They consider things like equitable relief, procedural fairness,

[284] J C Alexander, 'Contingent Fees and Class Actions' (1997) 47 DePaul L. Rev 347-361.

[285] John Coffee, 'The Regulation of Entrepreneurial Litigation: Balancing Fairness and Efficiency in the Large Class Action' (1987) 54 University of Chicago Law Review 877, 889.

[286] Brian T. Fitzpatrick, 'An Empirical Study of Class Action Settlements and Their Fee Awards' (2010) 7(4) Journal of Empirical Legal Studies 811, 845-846.

and alignment with the class's collective interests before approving them.[287] This is especially crucial in the case of securities class actions, where attorneys' fees have become a focal point of judicial scrutiny. [288] Specifically, any class member retains the right to object under FRCP Rule 23(e)(5), even if the settlement agreement has already undergone judicial review.[289]

While settlements provide harmed investors with a more certain and timely recovery, critics question whether they truly discipline issuers or simply allow lawyers and plaintiffs to extract wealth.[290] Admittedly, the threat of a large settlement can deter future misconduct. [291] However, defendants may treat settlements as a routine business expense, particularly when the agreed-upon amount is less than the combined financial liabilities and reputational damage they would likely incur through litigation. In the end, this kind of rent-seeking behaviour may compromise the efficiency of the market. [292]

3.4 Summary

[287] *In re Prudential Ins. Co. Am. Sales Prac. Litig. Agent Actions*, 148 F.3d 283, 317 (3d Cir. 1998).

[288] Lynn A. Baker et al., 'Setting Attorneys' Fees in Securities Class Actions: An Empirical Assessment' (2013) 66 Vand. L. Rev 1677, 1717.

[289] Federal Rules of Civil Procedure Rule 23 (e)(5).

[290] Eg John C Coffee Jr, 'Reforming the Securities Class Action: An Essay on Deterrence and Its Implementation' (2006) 106 Colum L Rev 1534-1586.

[291] See Chapter I Section 1.1.

[292] J C Alexander, 'Do the Merits Matter: A Study of Settlements in Securities Class Actions' (1990) 43 Stan L Rev 497, 528.

Securities class actions serve as a cornerstone of investor protection in the U.S. market. They serve to consolidate multiple claims into a single lawsuit, a necessity when individual claims may be too minor to justify separate litigation. Thus, class actions not only enhance judicial efficiency but also provide a robust framework for addressing collective securities claims.

The class action commences with class certification, a crucial phase where the court evaluates whether a proposed class meets certain criteria. Under FRCP Rule 23(a), several prerequisites must be satisfied for a class to be certified. Firstly, the class must be sufficiently large, generally numbering at least 40 members, to justify the action. Here, courts require concrete evidence to demonstrate numerosity, ensuring that claims are not based on mere speculation. Second, the representative parties' claims or defences must centre on factual or legal issues that affect the entire class. While not every issue needs to be identical, there must be a substantial overlap in the core elements shared among class members. This commonality requirement ensures that the class action mechanism effectively resolves the collective concerns of the group in a unified manner. Thirdly, the claims or defences raised by the representative must also mirror those of the broader class, ensuring their interests remain consistent with the group they represent. This consistency is critical to creating an effective framework for resolving the class's legal disputes collectively. Lastly, the representative must appropriately protect the class members' interests while avoiding conflicts of interest. These standard demands that legal counsel is qualified and fully committed to advancing the class's collective interests.

The commencement of a class action further falls under Rule 23(b)(3), which asserts whether class actions are the best way to solve securities disputes. The first test is Predominance, which ensures that the case can be efficiently litigated as a class by mandating that the core legal or factual issues are substantially common across all members. The second one is Superiority, which assesses the merits of a class action in resolving the claims and determines whether it is more successful than individual litigation.

A notable feature of securities class actions is the opt-out provision under Rule 23(b)(3). It grants class members the right to opt out of the collective proceeding if they choose to retain the ability to pursue separate claims independently. Unlike the opt-in system, where individuals must actively join the class, the opt-out system automatically includes potential plaintiffs. This inclusivity enhances the class's representativeness and bargaining power, reducing the risk of missing out on collective redress due to inaction or ignorance. Thus, class actions provide significant benefits in investor protection. By aggregating claims, they enable investors to seek damage collectively, which might otherwise remain unresolved due to limited resources. Besides, the “cost rule” in class actions reduces litigation expenses per plaintiff. Without this protection, the risk of being forced to pay the defendant’s legal fees if they lose could deter plaintiffs from filing suits in the first place. Meanwhile, the contingency fee arrangement, where attorneys receive a percentage of any settlement or award, further incentivises legal representation for class members.

From the perspective of behaviour, a large, representative class increases bargaining power, making defendants more likely to settle. This collective strength often results in more substantial settlements compared to what individual investors might achieve. Additionally, this collective behaviour streamlines judicial processes by consolidating similar claims, avoiding the burden of multiple overlapping lawsuits, and benefiting both the courts and litigants.

In essence, class actions under U.S. securities law offer a powerful mechanism for investor protection. They address widespread grievances, enhance bargaining power, and ensure efficient management of collective claims. The opt-out system, in particular, ensures broad inclusivity and effective representation, making class actions a vital tool in safeguarding investor interests.

In sum, the combination of Class Action and Causes of Action constitute a potent investor protection framework. Class actions achieve individual redress through an accessible, cost-effective procedure, leading to powerful outcomes especially in substantial settlements. Simultaneously, the causes of action under U.S. securities law, with their focus on reducing the burden of proof and simplifying the litigation process, ensure that investors can pursue claims without facing prohibitive challenges. The strict liability framework, constructive fault doctrines, and relaxed reliance thresholds collectively enhance the legal system's accessibility and effectiveness for investors. While causes of action facilitate more effective litigation, Class Action procedures ensure that collective litigation is facilitated appropriately and efficiently. Together, these mechanisms provide a synergistic framework for investor protection.

4. Discussing Complementarities: Investor Protection under Securities Public Enforcement

4.1 SEC Securities Enforcement

In the U.S., unlike securities private enforcement, the entity responsible for public enforcement is the regulatory agency overseeing securities laws, namely the SEC. The SEC has an overarching mandate for investor protection.

In this manner, public enforcement also serves the goal of protecting investors from fraud, mis-disclosure and damage entailing from securities law breaches. The operation of this public enforcement mechanism differs significantly from private enforcement. Under the U.S. securities legal framework, the SEC wields expansive powers to uphold federal securities laws via diverse enforcement mechanisms. Unlike private enforcement in securities cases that generally empowers harmed investors or their legal representatives to pursue litigation to seek redress in the court, public enforcement is managed by the SEC whose objectives in investor protection lie beyond investor compensation.

4.1.1 The Scope of SEC Enforcement: Focus Area and Trends

At the core of the SEC's enforcement authority lies Section 17 of the Securities Act of 1933,[293] which empowers the SEC to take action against any entity or individual that violates securities laws. This foundational rule allows the SEC to regulate fraudulent activities across a wide spectrum of market participants, ensuring that those who engage in securities violators face substantial penalties. The SEC's ability to execute this authority is reflected in its regular enforcement actions, particularly in addressing defective

[293] 15 U.S. Code § 77q.

disclosures related to issuers' reporting and securities offerings, which are central to private securities enforcement.

	Total Standalone Securities Enforcement Actions	Securities Offerings	Issuer Reporting / Audit & Accounting	Investment Advisers / Investment Companies	Broker Dealer	Insider Trading
2023	501	164	86	86	60	32
2022	462	106	76	119	46	43
2021	434	142	53	120	36	28
2020	405	130	61	85	40	31
2019	526	110	89	189	37	31

Figure 3: Table of SEC Standalone Securities Enforcement Actions (2019-2023)[294]

Each year, the SEC brings a series of enforcement actions that can be broken down into several classifications, reflecting its focus on different areas of securities laws. As we can see, the table (Figure 3) has categorised enforcement actions into the following segments: Securities Offerings;[295]

[294] SEC, *Addendum to Division of Enforcement Press Release Fiscal Year 2023*, 1; SEC, *Addendum to Division of Enforcement Press Release Fiscal Year 2022*, 1; SEC, *Addendum to Division of Enforcement Press Release Fiscal Year 2021,* 1; SEC, *Annual Report Division of Enforcement*, 2020, 16-17; SEC, *Annual Report Division of Enforcement*, 2019, 15-16.

[295] These enforcement actions address violations related to securities offerings, particularly those that violate registration requirements or involve fraudulent offerings. These cases are critical because unregistered or misleading offerings pose significant risks to investors, particularly retail investors who may not fully understand the nature of the securities they are purchasing.

Issuer Reporting / Audit & Accounting;[296] Investment Advisers / Investment Companies;[297] Broker-Dealer;[298] Insider Trading and Others.

When analysing the data from 2019 to 2023, it becomes evident that enforcement actions related to defective disclosures, are a major focus of SEC enforcement. This category consistently accounts for a substantial portion of the SEC's enforcement efforts. In 2023, for instance, enforcement actions related to "Securities Offerings" and "Issuer Reporting / Audit & Accounting" combined to account for approximately 49.9% of the total standalone enforcement actions. This significant figure reflects the SEC's continued focus on defective disclosures.

4.1.2 The Mechanisms of Enforcement: Administrative Proceedings and Civil Actions

Administrative proceedings and civil actions are the two main enforcement tools used by the SEC.

[296] This category targets companies that fail to comply with their financial reporting obligations under the Securities Exchange Act of 1934. Such failures can involve fraudulent accounting practices, inadequate internal controls, or deficiencies in audit processes. Accurate financial reporting is fundamental to investor confidence, and the SEC devotes significant resources to ensure that issuers maintain transparency in their financial disclosures.

[297] Investment advisers and investment companies are subject to strict fiduciary duties, and the SEC focuses on misconduct in this sector, including failures to disclose conflicts of interest or breaches of fiduciary responsibility. The emphasis here is on ensuring that investment professionals act in the best interests of their clients.

[298] Broker-dealer misconduct, including issues related to sales practices, market manipulation, or regulatory compliance failures, forms another area of SEC enforcement. Broker-dealers play a critical intermediary role in the securities markets, and failures in this area can lead to widespread harm to investors

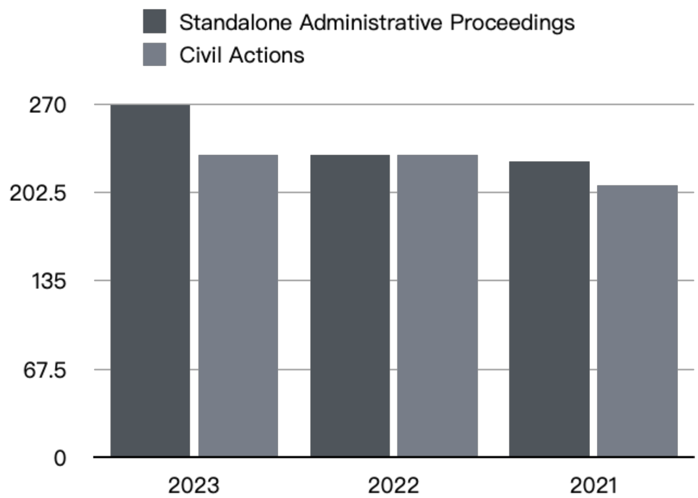

Figure 4: Table Comparing Volume of SEC Standalone Enforcement Actions and Civil Actions

Firstly, a key component of the SEC's enforcement is administrative proceedings. This proceeding, in which cases are decided by administrative law judges (ALJs) appointed by the SEC, has historically been a major one. The popularity of administrative proceedings has grown, and in recent years, nearly half of the SEC's enforcement actions have been pursued through this proceeding. Here, this proceeding is initiated by the SEC itself, and thereby it provides the SEC with greater control over the resolution of cases.

Cases involving defective disclosures by listed issuers may result in administrative proceedings. One notable case illustrating the SEC's use of administrative proceedings is *SEC v. Weatherford International PLC*.[299] In this case, the SEC accused the multinational oilfield services provider

[299] *SEC v. Weatherford International Ltd*., Civil Action No. 4:13-CV-03500 (S.D. Tex.) [Litigation Release No. 22880 November 26 2013].

Weatherford International PLC of providing misleading disclosures about its financial situation under the Securities Exchange Act of 1934's Section 10(b) and Rule 10b-5. The investigation shows that Weatherford misrepresented its income tax expenses by over $900 million between 2007 and 2012, committing materially false disclosures. The company's reported earnings were greatly inflated by these misleading figures, which also made the company's financial performance seem better than it actually was. This fraudulent activity had serious consequences. After the company's actual financial situation was revealed, Weatherford's stock price plummeted, causing significant losses for investors. Enforcement actions were taken by the SEC against Weatherford and three executives who were directly involved in the scheme. In the end, Weatherford was ordered to pay a fine of $140 million. Penalties were also imposed on the company's executives for their involvement in the misconduct, including the Vice President of Tax, Chief Financial Officer, and Chief Accounting Officer.

Second, rather than using administrative procedures, the SEC could file civil actions in federal courts. Unlike administrative proceedings, civil actions are subject to all federal court procedural protections and grant defendants the right to a jury trial.[300]

[300] *SEC Civil Action Road Map* <https://www.sec.or.th/EN/Documents/EnforcementIntroduction/flowchart_civil_en.pdf.> accessed 15 March 2025.

For example, *SEC v. WorldCom*[301] represents a historic case connected to one of the biggest accounting scandals in history. In order to artificially inflate its reported earnings, WorldCom, a significant telecommunications company, orchestrated systemic accounting manipulation. In the end, WorldCom greatly overstated its profitability by falsely classifying more than $3.8 billion in regular operating expenses as capital expenditures. In 2002, its stock fell when the full scope of the fraud was revealed. This scandal severely damaged public confidence in the financial markets and resulted in billions of dollars in losses for investors. Thus, the SEC responded by accusing WorldCom and its executives of violating securities laws, including Rule 10b-5, and bringing civil action against them.

In this case, the magnitude of the fraud and the broad remedies the SEC sought made the civil action against WorldCom noteworthy. The SEC aimed to impose significant financial penalties on the company and its executives and sought to recover losses for investors. The federal court system provided the necessary forum for adjudicating this complex case, and ultimately, the civil action played a key role in holding WorldCom accountable for its misconduct.

4.2 Compensation of Investor Loss from SEC Enforcement

[301] *SEC v. WorldCom, Inc.*, 273 F. Supp. 2d 431 (S.D.N.Y. 2003).

4.2.1 SEC Enforcement by Type of Action

Administrative proceedings and civil actions entail different consequences, meeting a range of public interest objectives besides investor compensation.

Firstly, administrative proceedings initiated by the SEC can result in several types of enforcement consequences.[302] One is the imposition of fines. Conceptually, fines are civil monetary penalties levied against individuals or entities that have violated securities laws. Besides fines, another severe penalty in administrative proceedings is the issuance of cease-and-desist orders. Functionally, these orders prohibit individuals or entities from continuing any securities-related activities.[303] Lastly, disgorgement is also a powerful administrative penalty. The consequence of disgorgement involves the repayment of profits obtained through illegal activities, and it aims to strip violators of any financial gains from their unlawful actions. Notably, this penalty serves a dual purpose: it denies violators the benefits of their misconduct and reinforces the principle that illegal profits must be returned.[304]

[302] Ralph C. Ferrara & Philip S. Khinda, 'SEC Enforcement Proceedings: Strategic Considerations for When the Agency Comes Calling' (1999) 51 Admin. L. Rev 1143, 1173-1194.

[303] Ibid.

[304] See Section 4.2.3.

Next, in civil actions, the SEC seeks various remedies to address securities law violations. An injunction is one of the primary remedies, and it is a court order that forces a defendant to perform certain actions or refrain from performing them. In practice, the SEC uses this remedy to stop unlawful activity and stop it from happening again. In addition to injunctions, the SEC may pursue ancillary remedies in civil actions.[305] Ancillary remedies include asset freeze orders, receiverships, and additional forms of equitable relief. For instance, the case of *Los Angeles Trust Deed & Mortgage Exchange v. SEC* in 1960 established the SEC's ability to request equitable relief such as appointing a receiver to manage and protect assets of the violator.[306] Subsequent cases have shown that the SEC can request and obtain asset freezes, disgorgement, and civil monetary penalties. Overall, the SEC is better equipped to handle complicated violations and safeguard investor interests due to these ancillary remedies.[307]

Among those consequences/remedies, civil monetary penalties and disgorgement are particularly important in compensating harmed investors, which is the main focus of the majority of private securities litigation.

[305] Eg J. R. Farrand, 'Ancillary Remedies in SEC Civil Enforcement Suits' (1975) 89 Harv. L. Rev 1779, 1780.

[306] *SEC v. Los Angeles Trust Deed & Mortg. Exchange*, 285 F. 2d 162 (9th Cir. 1960).

[307] Eg *SEC v. Fifth Ave. Coach Lines, Inc.*, 289 F. Supp. 3 (S.D.N.Y. 1968); *SEC v. Manor Nursing Centers, Inc.*, 458 F.2d 1082 (2d Cir. 1972).

Specifically, investors who have suffered because of securities law violations may be able to obtain compensation through civil monetary penalties. Such compensation may be indirectly achieved through the use of fines to fund restitution or investor compensation initiatives. Besides, disgorgement is also essential for making up for losses suffered by investors. By requiring violators to return ill-gotten gains, disgorgement helps ensure that investors are compensated for their losses. These two SEC authorities to direct penalty and disgorgement proceeds toward investor relief will be discussed in more detail in Section 4.2.2 and Section 4.2.3.

4.2.2 Civil Monetary Penalties (CMPs)

The evolution of the U.S. regulatory framework for CMPs highlights ongoing initiatives to strengthen securities laws and protect investor interests.

Landmark laws, including the Insider Trading Sanctions Act 1984[308] and the Insider Trading and Securities Enforcement Act 1988[309], progressively broadened the SEC's enforcement powers.[310]

Next, the push to broaden CMPs beyond insider trading gained momentum following the 1987 findings of *the National Commission on*

[308] Public Law No. 98-376.

[309] Public Law No. 100-704.

[310] The Insider Trading Sanctions Act of 1984 increased the maximum civil fines. The Insider Trading and Securities Enforcement Act of 1988 further raised penalty caps and expanded the SEC's scope to obtain civil injunctions.

Fraudulent Financial Reporting (Treadway Commission).[311] This private-sector initiative, backed by accounting professionals, advocated for legislative reforms to combat fraudulent financial practices. The Securities Enforcement Remedies and Penny Stock Reform Act of 1990 was passed as a result of its initiative, and ultimately granted the SEC explicit authority to impose CMPs for a wide range of federal securities law violations. Further, subsequent amendments, including the Securities Act 1933 and Securities Exchange Act 1934, once more solidified the SEC's power to enforce these penalties.[312] As we can see, the SEC's use of CMPs has undergone substantial evolution. Among those changes, the most significant was the expansion of enforcement powers under the Securities Enforcement Remedies and Penny Stock Reform Act of 1990.[313] This law officially authorised the SEC to pursue CMPs through administrative proceedings and civil actions in federal courts, significantly enhancing the agency's enforcement reach.[314]

The application of CMPs possesses several distinctive features that differentiate them from other types of financial penalties.

[311] <https://www.sechistorical.org/collection/papers/1980/1987_1001_TreadwayFraudulent.pdf> accessed 6 May 2025.

[312] Matthew Scott Morris, 'The Securities Enforcement Remedies and Penny Stock Reform Act of 1990: By Keeping up with the Joneses, the SEC's Enforcement Arsenal Is Modernized' (1993) 7 Admin LJ Am. U. 151, 160-166.

[313] Public Law No. 101-429.

[314] Matthew Scott Morris (1993), note 313, 160-166.

Firstly, unlike other financial penalties, CMPs are not directly tied to the profits obtained from illegal activities. Instead, the amount is determined by the severity of the violation and other relevant factors.[315]

For example, the SEC may impose a CMP equal to the $1 million profit made by a violator who commits securities fraud, which would result in a $1 million penalty, but in cases of especially serious misconduct, the penalties may surpass the profits made. In recent years, there has been growing recognition of the need to strengthen the SEC's authority to impose CMPs. This is exemplified by the proposed Stronger Enforcement of Civil Penalties Act of 2019.[316] This proposed legislation aims to increase the maximum penalties that the SEC can impose on violators. Here, the maximum fine under this Act would be $1 million for individuals and up to $10 million for corporations for each violation. With this cap, the SEC's enforcement toolkit would be greatly expanded.

Second, one of the most important aspects of CMPs is the way in which the collected fines are distributed. Unlike some other types of fines that are

[315] D. Rosenfeld, 'Civil Penalties against Public Companies in SEC Enforcement Actions: An Empirical Analysis' (2019) 22 U. Pa. J. Bus. L. 135, 180.

[316] 03/16/2023 referred to the Committee on Banking, Housing, and Urban Affairs.

permanently absorbed into the general revenues of the U.S. Treasury, investors harmed by securities law violations usually receive a refund.[317]

The Fair Funds for Investors provision[318], introduced in 2002 under Section 308(a) of the SOX[319], significantly enhanced this utility of CMPs. Before this provision, the SEC had limited ability to provide compensation to harmed investors, as funds collected from civil penalties were usually transferred to the U.S. Treasury, leaving investors without direct compensation. Here, the Fair Funds provision significantly changed this situation because it allowed the SEC to distribute funds collected from CMPs to investors who suffered losses due to securities law violations.[320]

It should be noted that although the SEC retains discretion in deciding whether to distribute money from Fair Funds, empirical research supports its effectiveness in compensating investors. Urska Velikonja of Emory University conducted a comprehensive study on the Fair Funds provision. Her research found that the SEC's efforts to compensate investors through Fair Funds were more successful than initially anticipated, especially when compared to private securities litigation. A key advantage of the Fair Funds

[317] C. G. Newton, 'Show Me the Money: The SEC's Use of Distribution as A Tool for Investor Protection' (2024) 13 American University Business Law Review 141, 149.

[318] 15 U.S. Code § 7246.

[319] Public Law 107-204.

[320] SEC, *Report Pursuant to Section 308(c) of the Sarbanes-Oxley Act*, 21-33, <https://www.sec.gov/news/studies/sox308creport.pdf> accessed 1 Sept. 2024.

provision, as noted by Velikonja, is that defendants are more likely to contribute to Fair Funds distributions than to pay damages related to private litigation. This can be advantageous where private litigation faces procedural, economic, or evidentiary impediments despite the facilitative frameworks discussed in Sections 2 and 3. As a result, the Fair Funds provision is able to facilitate compensation by leveraging the SEC's enforcement power and its ability to secure compensation directly benefiting harmed investors.[321]

The CMPs can be enforced by administrative action and civil action led by SEC. The 2019 administrative action against Facebook, Inc. in the wake of the Cambridge Analytica scandal is a noteworthy example of the SEC's application of a fine.[322]

In this case, Facebook was charged by the SEC with deceiving investors about the scope of user data misuse by third parties. The administrative investigation showed that Facebook was not sufficiently disclosing the dangers of user data being misused by outside businesses, such as Cambridge Analytica, which exploited millions of Facebook users' data without their permission. This company's deceptive disclosures further caused material inaccuracies in its public financial reports, violating Sections 17(a)(2) and

[321] Urska Velikonja, 'How Fair Funds Changed Public Compensation and Strengthened SEC Enforcement' (2023)78 Business Lawyer 667-684.

[322] *SEC v. Facebook, Inc*. Case No. 3:19-cv-04241-JD (N.D. Cal) [Last Reviewed 2022].

17(a)(3) of the Securities Act of 1933. To resolve the allegations, Facebook agreed to a $100 million civil penalty as fine in July 2019, and then in 2020, the SEC established Fair Fund using the $100 million penalty and distribute the money to harmed investors.[323]

The *SEC v. Tesla, Inc. and Elon Musk* from 2018 was one of the most well-known civil actions involving the SEC's use of CMPs.[324]

In this case, Elon Musk, the CEO of Tesla, announced in a tweet in August 2018 that he was thinking of going private at $420 per share and that he had obtained finance. This statement caused a surge in Tesla's stock price. However, the SEC alleged that Musk had not actually secured the necessary funding or negotiated key terms with any potential funding sources. The SEC asserted that the tweet disseminated misleading information to investors, constituting a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5. During the investigation, Tesla and Musk agreed to pay a combined $40 million in CMPs, with Tesla paying $20 million and Musk personally paying an additional $20 million. With $40 million civil penalties,

[323] Ibid.

[324] *SEC v. Elon Musk* Case No. 18-cv-8865 (S.D.N.Y.); *SEC v. Tesla, Inc.* Case No. 18-cv-8947 (S.D.N.Y.) [Last Reviewed 2024].

similar to the *Facebook* case, the court created a Fair fund in 2020 and ultimately distributed them to harmed investors in 2022.[325]

In conclusion, over time, the legislative evolution of CMPs has strengthened the SEC's enforcement capabilities, allowing for more robust investor protection, and the development of provisions like the Fair Funds has further reinforced the function of CMPs, transforming them into a mechanism that not only punishes violators but also directly compensates harmed investors. At its core, CMPs play a crucial role in compensating and protecting investors by imposing financial penalties on securities laws violators.[326]

4.2.3 Disgorgement

In the early stages of securities public enforcement, the SEC relied primarily on injunctions as the main penalty for violations of securities laws. However, as securities violations grew in complexity, the need for more effective enforcement became apparent. As a result, case law started to expand SEC's toolkit.

With court support, this expansion started in the 1960s and signalled a significant move towards more comprehensive enforcement tactics. From the

[325] Ibid. The court entered an order creating a Fair Fund for the combined $40 million in penalties, and then oversee distribution to eligible investors.

[326] The court determined that cases involving civil penalties for fraud must be prosecuted in federal court, ensuring that defendants are entitled to a jury trial. *SEC v. Jarkesy,* No. 22-859 (2024).

1960s, the idea of ancillary relief—additional remedies that support primary judicial remedies—became essential to the enforcement of securities laws. For example, the role of ancillary relief in SEC actions was first solidified by Supreme Court decisions in *J.I. Case Co. v. Borak*[327] and *Mills v. Electric Auto-Lite Co.*,[328] which laid the foundation for broad enforcement tools. Among those additional tactics, one of the most useful to compensate victims is disgorgement. In *SEC v. Texas Gulf Sulphur Co.*,[329] a significant development occurred when the SEC effectively argued that disgorgement was also an exercise of the courts' inherent equitable authority to impose remedies ancillary to injunctive relief.

Specifically, the *Texas Gulf Sulphur* serves as a cornerstone in defining legal principles for disgorgement as a remedy that SEC can enforce in insider trading and misrepresentation cases. The case arose after Texas Gulf Sulphur Company (TGS), a mineral exploration company, discovered a rich copper and zinc deposit in Canada in November 1963. Rather than immediately disclose this valuable information to the public, TGS officials and other insiders secretly purchased company stock and options. Meanwhile, the company also issued a misleading press release in April 1964, downplaying the discovery. The SEC subsequently accused TGS and several of its insiders

[327] *J.I. Case Co. v. Borak* (1964), note 210.

[328] *Mills v. Electric Auto-Lite Co.*(1970), note 220.

[329] *SEC v. Texas Gulf Sulphur Co.*, 446 F.2d 1301 (2d Cir. 1971).

of violating securities laws. Here, two primary legal issues emerged in the case. The first issue concerned insider trading and the second one centred on TGS's misleading press release, which violated the mandatory disclosure requirement. At trial, the SEC argued for disgorgement—forcing the defendant to return illegal gains. As a precedent, the court's ruling established this as a valid SEC enforcement power moving forward.

Notably, disgorgement has a different main purpose, so the way it compensates victims works differently than CMPs.

Firstly, while CMPs are designed to penalise and deter, disgorgement aims to prevent unjust enrichment by ensuring that violators do not profit from their misconduct (unjust enrichment). Thus, disgorgement is strictly limited to recovering illegal profits. This was firmly confirmed by the U.S. Supreme Court in *Liu v. SEC* (2020), which we'll examine in detail below.[330]

To be clear, *Liu v. SEC* was not primarily about defective disclosure. Instead, it focused on the misuse of investor funds and the SEC's authority to seek disgorgement as a remedy. In this case, Charles Liu and Xin Wang raised nearly $27 million from foreign investors, claiming the funds would be used to build a cancer treatment centre, and they misappropriated the majority of

[330] *Liu v. SEC*, 591 U.S. 71 (2020); *Kokesh v. SEC,* 581 U.S. 455 (2017).

the money for personal gain and to pay promoters, rather than using it for the stated purpose of the investment.

The case's impacts, however, go beyond the particular situation of misappropriation of investor funds. Here, the SEC's enforcement to recover ill-gotten gains through disgorgement faces important limitations. At trial, the controversial issue was the proper calculation of disgorgement amounts. The court's ruling showed that the extent of disgorgement relief must be restricted to "net profits," requiring defendants' legitimate business expenses to be deducted from gross revenues when calculating recoverable amounts. Therefore, this restriction guarantees that disgorgement stays focused on taking away only the ill-gotten gains and stops the SEC from claiming all of the defendant's revenue.

Besides the scope of disgorgement, the penalty of disgorgement is broadly applicable, allowing it to be imposed not only on the direct violators of securities laws but also on those who indirectly benefit from the illegal activities.

For instance, in *SEC v. First Jersey Securities, Inc.*[331], the SEC initiated a civil action against First Jersey Securities, Inc. and its executives. The SEC accused the defendants of participating in fraudulent schemes to sell

[331] *SEC v. First Jersey Securities, Inc.*,101 F.3d 1450 (2d Cir. 1996).

unregistered securities, distributing deceptive details about the securities' characteristics that misled investors into purchasing high-risk products. The court ruled that defendants could face joint and several liability for disgorgement, irrespective of their direct involvement in the misconduct. Here, the ruling showed that disgorgement ensures that those closely involved in or benefiting from securities violations are also held accountable.

Further, disgorgement applies to the asset itself (in rem), meaning the property can be recovered even if its title has been transferred.

In *SEC v. Whittemore*[332], Harvey Whittemore was a close friend and business associate of the chairman of U.S. Gold Corporation. Whittemore obtained material, non-public information regarding the company's upcoming merger with another mining company. Before the merger was publicly disclosed, Whittemore leveraged non-public information he obtained to acquire a substantial number of U.S. Gold shares. He did so with the expectation that the stock price would rise once the merger was announced. Following the public announcement of the merger, U.S. Gold Corporation's stock price did surge promptly, allowing Whittemore to sell his holdings for significant profit. In this case, the SEC accused Whittemore of violating Rule 10b-5 and Section 10(b) of the Securities Exchange Act of 1934 and sought

[332] *SEC. v. Whittemore*, 659 F.3d 1 (D.C. Cir. 2011).

disgorgement of his illicit profits. However, a significant portion of the profits had already been transferred. To address this, the court's ruling emphasised that disgorgement can still be enforced even if the defendants no longer hold or control the illegal profit. Thus, this approach ensures that disgorgement is provided with a peculiar legal feature (in rem) to trace the asset, ultimately protecting harmed investors.

In sum, the compensatory feature of the disgorgement means that the SEC is encouraged to distribute the disgorged funds to harmed investors in principle (through Fair Fund). This feature, established by the Supreme Court in *Liu v. SEC*, addresses concerns that some enforcements might retain disgorged funds and potentially disadvantage investors. Further, disgorgement's broad applicability to defendants and in rem nature gives it powerful compensatory capabilities as shown in *SEC v. First Jersey Securities*, Inc. and *SEC v. Whittemore.* In contrast, as we have discussed in Section 4.2.2, CMPs are punitive and compensatory. Thus, while the Stronger Enforcement of Civil Penalties Act of 2019 does not cap the amount of recoverable illegal profits, only the portion of CMPs deposited into the Fair Fund is distributed to harmed investors.

In conclusion, the evolution of disgorgement as a remedy in SEC enforcement actions has significantly shaped the landscape of the securities legal framework. Initially grounded in the courts' inherent equity powers, disgorgement has emerged as a crucial tool that transcends simple penalties by focusing on the removal of ill-gotten gains from violators and the protection of harmed investors. Key cases have defined disgorgement, ensuring it remains a distinct and effective remedy that emphasises compensatory over punitive objectives and requires disgorged funds to be returned to harmed investors.

4.2.4 Summary

In the U.S., securities public enforcement by the SEC is distinct from, but is complementary to private enforcement typically initiated by harmed investors. Here, the U.S. securities enforcement framework features both public SEC actions and private investor lawsuits—distinct mechanisms that work in tandem.

Firstly, the SEC has broad authority to enforce securities laws and can initiate enforcement actions independently. This allows it to efficiently compensate harmed investors without relying on coordination with private court proceedings.

Specifically, the SEC's enforcement process generally involves three stages: investigation, the Wells notice, and enforcement action. After investigation, if SEC staff believe that enforcement action may be warranted, a Wells notice is issued to inform the subject of potential violations and to provide an opportunity to respond. Further, if the SEC decides to proceed, it can initiate administrative proceedings (or civil actions). Notably, administrative proceedings, conducted by SEC-appointed judges (ALJ), offer a quicker resolution and can result in fines, disgorgement, and cease-and-desist orders. Ultimately, the SEC has complete control over the entire process of enforcement.

Second, the SEC's enforcement actions can result in financial compensation for investors through CMPs and disgorgement, which enable harmed investors to seek damage.

The Insider Trading Sanctions Act of 1984 and the Securities Enforcement Remedies and Penny Stock Reform Act of 1990 have reinforced CMPs, which are fines based on the seriousness of the violation rather than profits made. The SOX of 2002 further enhanced the SEC's ability to compensate harmed investors through the Fair Funds for Investors provision, which pools CMPs and disgorged funds into a Fair Fund for direct distribution to investors. This action is led by the SEC, and it could prove more effective than private litigation since harmed investors cannot overcome challenges in proving causation and damages.

Compared to CMPs, disgorgement requires violators to repay profits gained from illegal activities, primarily serving as a compensatory tool.

Historically, disgorgement gradually became an essential remedy to ensure violators do not profit from misconduct. Moreover, as established in key precedents, disgorgement has greater recovery potential than causes of action. This advantage stems from its broad defendant classification and in rem (asset-based) nature, as opposed to the limitations of tort-based damages.

Overall, the SEC's enforcement actions, including CMPs and disgorgement, are vital in compensating harmed investors and upholding market integrity. By stripping violators of illicit profits and penalising violations, these mechanisms provide an efficient alternative to private litigation, highlighting the importance of public enforcement in addressing securities violations and compensating harmed investors.

4.3 Compensation Complementarity Between SEC and Private Enforcement: A Data Analysis

This section investigates the complementarity between public enforcement by the SEC, which compensates investors and investors' private securities litigation, in order to appraise how investor protection in U.S. securities markets is effectively achieved. To this end, this section compares the compensation data between 2015 and 2023.

4.3.1 Securities Enforcement Data and Dataset

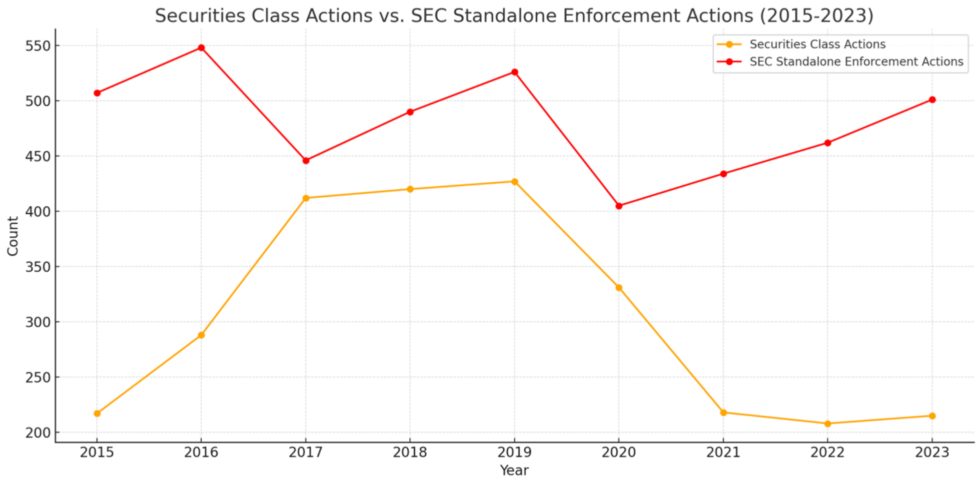

Figure 5: Securities Class Actions vs. SEC Standalone Enforcement Actions (2015-2023)[333]

A comparison of trends in SEC standalone enforcement actions and private securities class actions from 2015 to 2023, as depicted in *Figure 5*, highlights the SEC's predominant role in securities enforcement and its significant impact on the market. From 2015 to 2023, SEC enforcement actions consistently outpaced private securities class actions, underscoring the agency's proactive approach to market oversight. The data reveals that while private class actions fluctuated between 200 and 400 cases per year, SEC enforcement actions frequently exceeded 500 cases annually, particularly in the earlier years such as 2016 and 2018. This consistent disparity between the volume of SEC actions and private class actions demonstrates the SEC's dominant presence in policing the market.

[333] Cornerstone Research (2024), note 148, 4; Gibson Dunn, *2023 Year-End Securities Enforcement Update*, (2024 Gibson, Dunn & Crutcher LLP 2024) 1-2.

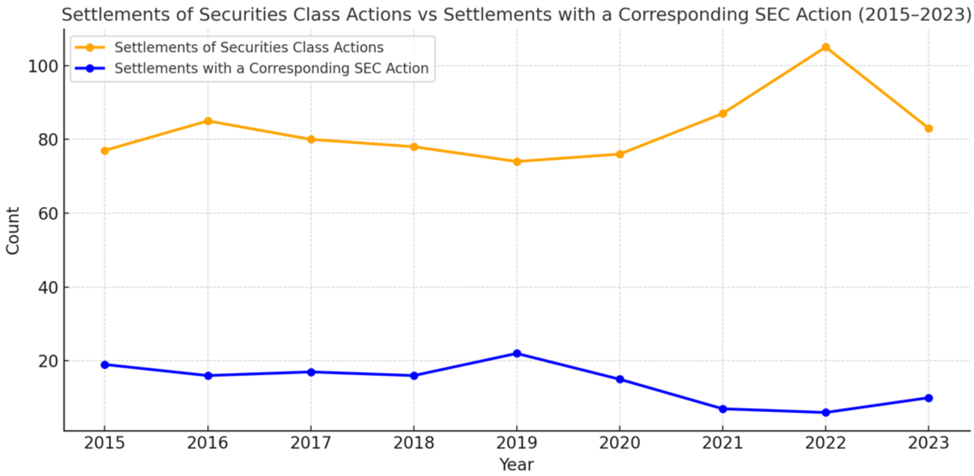

Figure 6: Settlements of Securities Class Actions vs. Settlements with a Corresponding SEC Action (2015-2023)[334]

Figure 6 compares the annual count of settlements in securities class actions with those involving corresponding SEC actions from 2015 to 2023. The orange line represents the total number of securities class action settlements, which ranged from around 70 to 100 per year. The peak occurred in 2022, with around 100 settlements, followed by a decline in 2023 to just above 80. In contrast, the blue line shows the number of settlements that also involved a corresponding SEC action. These numbers are consistently much lower, remaining below 20 for the entire period. The highest point in the blue line appears in 2019, with slightly above 15 cases, and the lowest in 2021, with fewer than 5. The data suggests that while securities class action settlements are numerous, only a small portion involve SEC actions.

[334] Cornerstone Research, *Securities Class Action Settlements 2023 Review and Analysis* (Cornerstone Research 2023) 3+12.

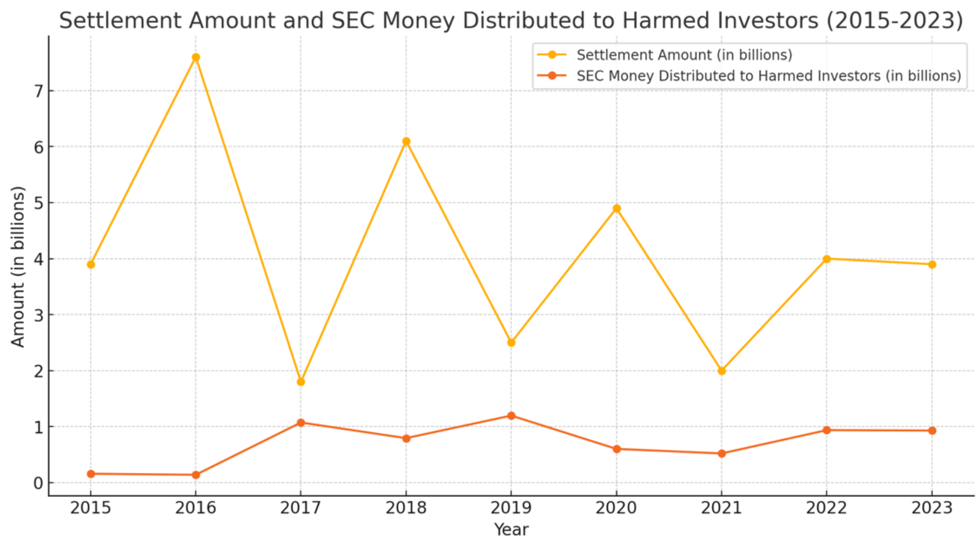

Figure 7: Settlement Amount and SEC Money Distributed to Harmed Investors (2015-2023)[335]

Figure 7 compares the total settlement amounts in securities class actions with the SEC money distributed to harmed investors from 2015 to 2023. The yellow line represents the total settlement amounts (in billions), showing significant fluctuations throughout the period. The most notable spikes are in 2016 and 2018, where settlement amounts reached nearly $8 billion and $6 billion, respectively. These peaks are followed by sharp declines, particularly in 2017 and 2021, when settlements dropped to around $2 billion and $1 billion. However, the amounts stabilise between $3 and $5 billion in recent years (2022–2023). The orange line represents SEC money distributed to harmed investors, which remains consistently lower throughout the entire

[335] Cornerstone Research (2023), note 334, 3; SEC, *Annual Report Division of Enforcement*, 2018, 11; SEC (2023), note 294, 2.

period. The amounts distributed are generally below $1 billion each year, with only a slight rise to around $1 billion in 2019 and 2022.

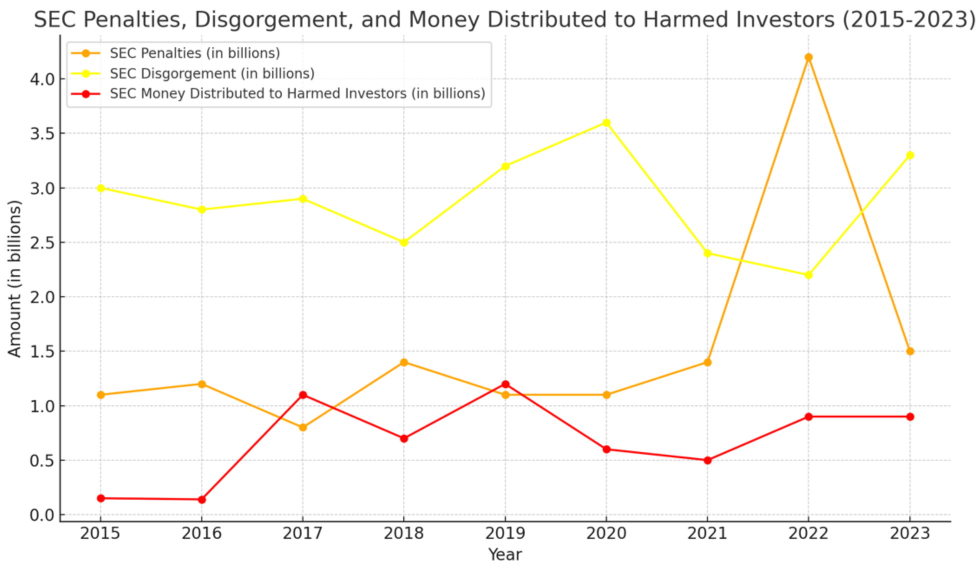

Figure 8: SEC Penalties, Disgorgement, and Money Distributed to Harmed Investors (2015-2023)[336]

From *Figure 8*, we observe that SEC disgorgement has been relatively stable, fluctuating between $2.2 billion and $3.6 billion during this period. The highest disgorgement occurred in 2020, with $3.6 billion, while the lowest was $2.2 billion in 2022. SEC penalties peaked dramatically in 2022 at $4.2 billion, the highest value by far across the years, followed by a sharp decrease to $1.5 billion in 2023. Conversely, 2017 saw the lowest penalty amount of $0.8 billion. The money distributed to harmed investors exhibits significant volatility, peaking at $1.2 billion in both 2017 and 2019. In

[336] SEC (2018), note 335, 11; SEC (2023), note 294, 2.

contrast, 2016 and 2020 had some of the lowest distributions, with just $0.14 billion and $0.6 billion, respectively.

4.3.2 Analysis and Critique

4.3.2.1 The Dominance of SEC Enforcement v. Private Class Actions

The trend depicted in *Figure 5* reflects a key observation: the SEC is significantly more active in addressing regulatory violations than private parties. While private securities class actions serve as an important tool for investor protection by allowing individuals to seek redress for securities fraud, they are relatively reactive, addressing issues only after investors have already suffered losses.

In sum, the data from 2015 to 2023 highlights the SEC's critical role in U.S. securities enforcement. The agency's actions far exceed those of private class actions, reflecting its pivotal role in market oversight and investor protection. By proactively identifying and addressing securities law violations, the SEC's robust enforcement efforts are essential in maintaining the integrity of the U.S. securities market, protecting investors, and ensuring that the market functions effectively for all participants.

4.3.2.2 The Independent Role of Private Class Actions in Investors Compensation

Notably, *Figure 5* may overstate the SEC's impact or understate the role of class actions, as both mechanisms can operate in parallel. This limitation arises from the figure's focus on the number of enforcement actions rather than on their actual effectiveness in compensating harmed investors. Thus, to gain a more comprehensive understanding, it is essential to evaluate the independence of both the SEC's enforcement actions and class action through the lens of financial compensation.

From a compensation standpoint, what has to be mentioned first is that class action settlements are particularly effective in addressing the financial damages suffered by investors. Research has shown that private securities settlements can amount to larger amounts and more distribution to investors, although it is possible to see the large settlements as wealth extraction from the companies.[337] Further, since these settlements are the result of negotiations between plaintiffs' attorneys and defendants, often leading to substantial financial compensation distributed directly to affected investors, this process allows investors to recover losses more efficiently compared to other legal remedies.

Next, *Thomas Cox*'s empirical evidence supports the notion that private securities litigation achieves more successfully the compensation function.

[337] Eg J C Alexander (1990), note 292, 528.

Nevertheless, there is an interaction between private securities class actions and SEC enforcement efforts, as these two enforcement avenues complement each other to improve the class action's overall compensation function. The study highlights the interplay between SEC enforcement actions and securities private enforcement, demonstrating how these mechanisms work together to enhance the compensation function of private litigation. The study finds that approximately 15% of securities private enforcement cases involve parallel public enforcement proceedings by the SEC. In these situations, defendants are usually more likely to settle for higher amounts because of the additional pressure of handling both SEC and private investor actions. This is particularly beneficial for investors because settlements made under such pressure usually yield higher compensation.[338]

However, when it comes to independence, the data presented in *Figure 6* provides further insight into the compensation impact of class actions, revealing that most class action settlements occur independently of SEC enforcement actions. Therefore, this finding underscores the distinct and independent role of private securities class actions in the market, but it does not deny that a portion of private enforcement cases involve parallel public

[338] James D. Cox, Randall S. Thomas & Dana Kiku, 'SEC Enforcement Heuristics: An Empirical Inquiry' (2003) 53 Duke LJ 737, 763.

enforcement proceedings that result in effective oversight and discipline of the issuers in the U.S. securities markets.

4.3.2.3 Compensation Stability in SEC Enforcement

In *Figure 7*, compensation figures fluctuate, marked by significant declines in 2017 and 2021, where Settlement Amounts fell to their lowest at $1.8 billion and $2.0 billion, respectively. These fluctuations suggest that the amounts recovered from violators through settlements can vary widely, influenced by the nature and success of the cases brought forward.

In contrast, the SEC Money Distributed to harmed investors shows a more consistent pattern, with relatively minor fluctuations over the same period. Although the distributed amounts are modest compared to Settlement Amounts, the stability of these distributions underscores a key strength of SEC enforcement actions. This consistency ensures that harmed investors receive some form of compensation, even during years when settlement values are lower, maintaining a level of assurance in the enforcement system.

The data arguably underscores the vital role of SEC enforcement actions in compensating harmed investors. A stable pattern of investor compensation through public enforcement is crucial because it ensures that harmed investors receive compensation even when private securities enforcement, such as class actions, is less active or less successful.

In conclusion, the U.S. securities enforcement landscape is characterised by a complementary relationship between SEC enforcement actions and private securities enforcement. Both mechanisms play critical, albeit distinct, roles in compensating harmed investors and upholding market integrity. While the scale of SEC's compensation is often smaller, it offers a stable regulatory approach that consistently compensates investors. In contrast, private enforcement through class actions provides the potential for substantial payouts in significant cases.

4.3.2.4 Evaluating Compensation Efficiency of SEC Enforcement

Data from *Figure 8*, comparing SEC penalties, disgorgement, and the amount distributed to harmed investors from 2015 to 2023, reveal a stark gap between the financial penalties collected by the SEC and the restitution actually reaching harmed investors.

One of the most striking insights from *Figure 8* is the large disparity between the amounts collected through SEC-imposed penalties and disgorgement, and the much smaller sums ultimately distributed to investors. Over the period from 2015 to 2023, the SEC consistently imposed penalties and disgorgement totalling over $5 billion annually. However, the funds distributed to harmed investors rarely exceeded $1 billion in most years. This gap is especially notable in years like 2017 and 2022.

This disparity raises critical questions about the SEC's enforcement strategy and its capacity to fulfil its investor protection mandate. There are questions surrounding the SEC's transparency and accountability in deploying recovered sums, as well as the cost-effectiveness and efficiencies of its processes. Further, there may be inefficiencies in the process of identifying harmed investors and channelling recovered funds to them.

To address meaningful restitution to investors, reforms in the SEC's enforcement mechanisms, particularly in the area of fund distribution, may be necessary. Streamlining the process for identifying harmed investors and improving the efficiency of fund allocation could help reduce the gap between financial recoveries and investor compensation. Additionally, the SEC could be more transparent in explaining how collected penalties and disgorged funds are directed toward restitution and manage more effectively against their being absorbed into general government funds or regulatory expenses.

4.3.3 Summary: The Market Size and its Role in Shaping Securities Private Enforcement

The relationship between SEC enforcement and private securities class actions in compensating investors reveals a complementary but distinct dynamic. SEC enforcement is proactive, using its extensive regulatory powers to address misconduct and prevent damage before it escalates. This regulatory reach allows the SEC to stabilise market confidence and enforce legal compliance on a large scale. But it should be noted that even though the SEC receives large fines and disgorgements, the actual amount of money given to harmed investors is constantly small, exposing inefficiencies in the distribution of funds.

In contrast, private class actions are excellent at providing direct financial compensation, despite being relatively reactive and taking place after investors have lost money. Besides, the compensation of class actions functions independently from SEC enforcement and frequently result in sizeable settlements. These features are essential to investor redress, especially in cases where SEC enforcement fails to provide adequate compensation.

In sum, both mechanisms have compensatory strengths: SEC enforcement ensures consistent, albeit smaller, compensation, reinforcing legal accountability, while private class actions offer the potential for larger payouts in significant cases. Together, they form a dual framework of investor protection.

This chapter analyses the rationale behind the U.S. complementary enforcement mechanism, arguing that market size is important for the structure of securities enforcement mechanisms in delivering effective investor protection. The U.S. securities market has surged from $24 trillion in 2013 to a peak of $48 trillion in 2021. The sheer scale of financial activity necessitates a nuanced approach to enforcement. Market size can serve as a foundational determinant for calibrating the balance between public and private enforcement.

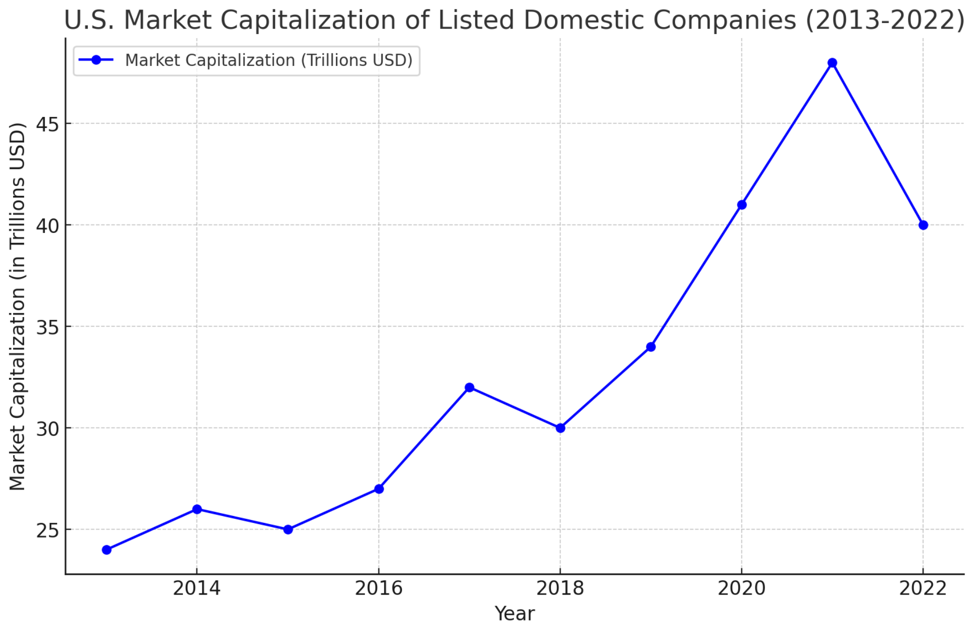

Figure 9: U.S. Market Capitalization of Listed Domestic Companies (2013-2022)[339]

In large, dynamic markets like the U.S., the limitations of public enforcement—exemplified by the SEC—become increasingly apparent. While the SEC's proactive regulatory actions, such as its consistent annual enforcement of 500+ cases from 2015 to 2023 underscore its critical role in

339 <https://data.worldbank.org/indicator/CM.MKT.LCAP.CD> accessed 2 June 2025.

deterring misconduct and maintaining market stability, its capacity to compensate harmed investors remains constrained. Above data reveal a stark disconnect: SEC penalties and disgorgements totalled billions annually, yet distributions to investors rarely exceeded $1 billion, with years like 2017 and 2022 highlighting significant gaps. This inefficiency in translating enforcement outcomes into meaningful restitution underscores the inherent challenges of relying solely on public mechanisms in vast markets.

Thus, the limitations of public enforcement compensation in large-scale markets create a compelling case for robust private securities litigation. Despite being reactive, private class actions show a special ability to provide investors with immediate and significant compensation. For example, private settlements routinely exceeded SEC distributions by a significant margin, averaging between $2 billion and $8 billion per year between 2015 and 2023. According to *Figure 6*, more than 80% of class action settlements took place without any corresponding SEC intervention, further demonstrating the independence of private proceedings. This autonomous compensation allows private litigation to address damages that public enforcement may overlook or deprioritise, thereby filling critical gaps in investor redress. Furthermore, the market-responsive traits of private actions, which adjust to the severity and prevalence of misconduct, is reflected in the volatility of settlement amounts, which peaked at $8 billion in 2016 and fell to $1 billion in 2021.

The need for a complementary private enforcement framework is further supported by the fact that, despite being stable due to its limitations, the SEC's compensation is still insufficient to handle the magnitude of losses in a trillion-dollar market.

On the other hand, the growing complexity and size of modern securities markets amplify the necessity of this dual approach. As market capitalisation expands, the SEC's resource-intensive enforcement model faces diminishing returns in compensating dispersed investors. Given its limited resources, it is reasonable that the agency's focus on systemic deterrence and precedent-setting cases, though vital for market integrity, often sidelines individualised compensation.

In contrast, private class actions prioritise direct financial recovery, leveraging collective action to aggregate diffuse claims into impactful settlements. This efficiency is particularly crucial in large markets, where investor loss is widespread and fragmented. Although critiques of private litigation—such as concerns over "wealth extraction" from companies—highlight the need for safeguards to balance accountability with fairness, empirical evidence, as shown in Thomas Cox's study, affirms that class actions uniquely align compensation with actual investor losses, a feat less achievable through SEC mechanisms in U.S. securities market.

Ultimately, the data strongly demonstrate that market size is a pivotal factor in shaping securities enforcement strategies. In the U.S., where market capitalisation exceeds $40 trillion, public enforcement alone cannot efficiently address the dual demands of deterrence and compensation. While the SEC's proactive enforcement is vital for maintaining market integrity, its limitations in compensating investors—highlighted by the persistent gap between penalties collected and funds distributed—necessitate a stronger reliance on private mechanisms. This gap is filled by class actions, which have the potential to provide significant, immediate compensation. In addition to relieving the SEC's workload, extending private enforcement through pro-investor instruments like class actions would strengthen the enforcement framework's overall resilience. All in all, a collaborative strategy that leverages the complementary strength of both public and private enforcement will be crucial to protecting investor interests and maintaining market confidence as markets continue to expand in size and complexity.

5. Conclusion

Securities litigation serves as a fundamental mechanism for investor protection in U.S. securities law. Securities litigation allows investors to seek redress through the courts, utilising features such as strict liability, constructive fault, and eased reliance requirements, which lessen investors' burden of proof. Investors can more easily seek compensation for losses resulting from substantial misrepresentations in securities transactions. Besides, class actions, a key tool in securities litigation, allow multiple investors to consolidate their claims, enhancing judicial efficiency and investors' bargaining power. Taken together, U.S. securities private enforcement could provide a collective avenue for investor protection, ensuring that claims are resolved in a cost-effective manner.

It is important to remember that in the U.S., there is a complementary dynamic between securities class actions and SEC enforcement. While SEC enforcement actions are often proactive and focused on preventing market misconduct, private securities litigation tends to be reactive, addressing damages after it has occurred. Further, the SEC's broad regulatory authority allows it to tackle systemic issues and enforce legal compliance, but private class actions play a critical role in delivering substantial compensation to affected investors. Together, these mechanisms ensure that investor protection is both preventative and compensatory, safeguarding the integrity of U.S. securities markets. However, due to the capacity in investor compensation in public enforcement, it is indispensable for investors to have recourse to private litigation in order to address their private rights.

Finally, the size of a securities market is a critical determinant of the balance between public and private enforcement. The U.S. market had grown to $48 trillion in capitalisation by 2021. A large securities market demands a range of enforcement mechanisms to address the increased complexity and volume of transactions. Although public enforcement is essential in discouraging securities violations, its effectiveness in compensating investors comparatively declines as market size increases. This inefficiency underscores the need to maintain and empower private enforcement, particularly through class actions, which provide direct, substantial compensation to investors and complement public efforts in maintaining market integrity.

Against this backdrop, the controversial private securities-litigation regime finds itself at a crossroads. If U.S. legislation does not raise the bar for bringing class actions, it risks encouraging "strike suits" that impose needless costs on issuers. But if U.S. legislation makes it too difficult to proceed, the sheer scale of the securities markets and the inherent limits of public enforcement could leave investors under-protected. To strike an appropriate balance between stable capital-raising costs and effective investor protection, a class action should proceed only when it meets the established substantive and procedural requirements and does not constitute a strike suit. A comparable filtering mechanism was employed in China's Securities Law (2019) and may serve as a useful model. This is further analysed in Chapter IV.

Chapter III

Securities Enforcement in the United Kingdom

1. An Overview of Securities Regulation in the U.K.

1.1 Legal Sources of Securities Regulation in the U.K.

The U.K.'s securities-regulation framework has evolved from a predominantly "EU-derived" regime into a uniquely on-shored system that retains much of the former EU Directives' structure while embedding post-Brexit legislative reforms.

Prior to Brexit, the U.K.'s securities regulation was largely derived from EU Directives.[340] Those Directives have provided the principles of securities regulation and regulatory details for regulators, including the regulation of securities prospectuses, listing on an exchange market, and trading shares.

For example, the Prospectus Directive lays out the core principles governing the listing and trading of securities, which are then implemented in

[340] The groundwork established high-level principles that repatched fragmented securities markets in the EU to make the markets more efficient and provide more sound protection for investors. Marco Onado, 'Is the Larosière Proposal on European Financial Regulation on the Right Path?' (2010) 45(1) The International Spectator 59.

the U.K. through the Financial Services and Markets Act 2000 (FSMA 2000), the Prospectus Regulations 2005, and the FCA Prospectus Rules.[341] These domestic instruments provide technical guidelines for compliance with the Prospectus Directive.[342] Their enforcement was ensured by the FCA as the U.K.'s competent regulatory authority.

The Transparency Directive[343] addresses secondary market information asymmetry. The Directive imposed requirements on "the disclosure of periodic and ongoing information about issuers whose securities are already admitted to trading on a regulated market situated or operating within a Member State."[344] The Transparency Directive was implemented in the U.K. by Part 43 of the Companies Act 2006 and the introduction of new "Disclosure Guidance and Transparency Rules" to the *FCA Handbook*.[345] Secondary market disclosure is also mandated to be timely, under

[341] Directive 2003/71/EC of the European Parliament and of the Council of 4 November 2003 on the prospectus to be published when securities are offered to the public or admitted to trading and amending Directive 2001/34/EC [2003] OJ L345/64 (Prospectus Directive); Financial Services and Markets Act 2000 (FSMA 2000); the Prospectus Regulations 2005; UK Financial Conduct Authority (FCA) Handbook, the Prospectus Regulation Rules ('PRR') sourcebook. See also Regulation (EU) 2017/1129 of the European Parliament and of the Council of 14 June 2017 on the prospectus to be published when securities are offered to the public or admitted to trading on a regulated market, and repealing Directive 2003/71/EC [2017] OJ L168/12 (EU Prospectus Regulation).

[342] See changes to align the *FCA Handbook* with the EU Prospectus Regulation: FCA, 'Changes to align the FCA Handbook with the EU Prospectus Regulation' (Consultation Paper CP19/6, January 2019).

[343] Directive 2004/109/EC of the European Parliament and of the Council of 15 December 2004 on the harmonisation of transparency requirements in relation to information about issuers whose securities are admitted to trading on a regulated market and amending Directive 2001/34/EC [2004] OJ L390/38 (Transparency Directive).

[344] Transparency Directive, art 1.

[345] Companies Act 2006, pt 43; *FCA Handbook*, Disclosure Guidance and Transparency Rules ('DTR') sourcebook.

requirements of real-time disclosure of inside information under the Market Abuse Regulation 2016.[346]

Lastly, the EU Markets in Financial Instruments Directives (MiFID 1 and 2) were implemented to increase competition among securities markets in member states.[347] They established a regulatory framework that required financial firms to comply with certain business principles, such as the principle of "best execution of transactions," designed to protect investors in brokered securities trading.[348] The MiFID framework was designed to regulate intermediaries supporting a transparent and effective securities market. Overall, the EU securities legislative frameworks aimed to safeguard market integrity and stability while ensuring investors retained access to accurate and timely market data.

Following Brexit, significant steps were taken to maintain legal continuity and stability. The European Union (Withdrawal) Act 2018 converted the body of applicable EU law as of 31 December 2020 into "retained EU law,"

[346] MAR, art 17. The EU Market Abuse Regulation (MAR) is formally numbered Regulation (EU) No 596/2014 (adopted in 2014, applicable from July 2016).

[347] Directive 2004/39/EC of the European Parliament and of the Council of 21 April 2004 on markets in financial instruments amending Council Directives 85/611/EEC and 93/6/EEC and Directive 2000/12/EC of the European Parliament and of the Council and repealing Council Directive 93/22/EEC [2004] OJ L145/1(MiFID 1) and Directive 2014/65/EU of the European Parliament and of the Council of 15 May 2014 on markets in financial instruments and amending Directive 2002/92/EC and Directive 2011/61/EU (recast) [2014] OJ L173/349 (MiFID 2). MiFID 2 focused on the transparency of European markets. Given the fragmented nature of EU markets, it was difficult to secure information on prices. With MiFID 2, the aim was to provide better sources of information on prices for investors.

[348] MiFID 1; MiFID 2.

effectively freezing the EU regulatory framework within U.K. domestic law.[349] From that point onward, EU Directives no longer applied directly; instead, their on-shored versions operated exclusively under U.K. jurisdiction. Subsequently, the Retained EU Law (Revocation and Reform) Act 2023, effective from 27 February 2025, aimed to streamline the legal landscape. In addition to removing general EU legal concepts like supremacy and direct effect from domestic interpretation, this Act eliminated the designation of "retained EU law" and replaced it with "assimilated law."[350]

Building upon this legislative foundation, the U.K. established a series of post-Brexit regulatory adaptations. Firstly, the U.K. Prospectus Regulation (UKPR) was created by on-shoring the EU Prospectus Regulation ((EU) 2017/1129). While maintaining its core structure, significant changes included the elimination of prospectus passporting arrangements with the EEA and the empowerment of the FCA to recalibrate thresholds and exemptions under the newly devised Public Offers and Admissions to Trading Regime (POATRs).[351] Second, the UK MiFID framework now consists of on-shored MiFID 2/MiFIR rules embedded into the *FCA Handbook* and

[349] Eg Paul Craig, 'Constitutional Principle, the Rule of Law and Political Reality: The European Union (Withdrawal) Act 2018' (2019) 82(2) MLR 319-350.

[350] Catherine Barnard, 'The Retained EU Law Revocation and Reform Act 2023: What It Is and What It Does (UK)' (2023) 8 Eur Emp L Cases 158-162.

[351] Raj Panasar, James Healy, Kathryn Collar et al., 'The New Prospectus Regulation: The Story So Far' (Cleary Gottlieb, 2019) 4, 12. <https://www.clearygottlieb.com/-/media/files/alert-memos-2019/the-new-prospectus-regulation-the-story-so-far-v2.pdf> accessed 3 May 2025.

supplementary U.K. regulations. Minor amendments, such as the relocation of technical standards and adjustments to transparency thresholds, were made to ensure the system operates effectively without relying on EU institutions.[352] Finally, the FSMA 2000 remains the primary legislative backbone for financial services, but has been updated by FSMA 2023, which grants broader rule-making powers to the FCA, revokes outdated EU-derived provisions, and streamlines financial-services legislation.[353] The FSMA 2000 (Exemption) Order 2025 further refines the regulatory perimeter to reflect domestic policy priorities.[354]

While Brexit triggered a series of structural and formal changes to the U.K.'s securities-regulation framework, the reforms predominantly focused on technical and procedural stability rather than on altering substantive regulatory standards. The pre- and post-Brexit developments reveal a continuity of fundamental principles, with most modifications aimed at ensuring the functionality and autonomy of the U.K.'s securities-regulation system.

[352] FCA, 'Regulation of Markets in Financial Instruments' (11 August 2023) <https://www.fca.org.uk/markets/regulation-markets-financial-instruments> accessed 15 April 2025.

[353] The Financial Services and Markets Act 2000 (Disapplication or Modification of Financial Regulator Rules in Individual Cases) Regulations 2024, SI 2024/539.

[354] The Financial Services and Markets Act 2000 (Exemption) (Amendment) Order 2025, SI 2025/250.

This chapter turns to examine the key tenet of investor protection within U.K. securities legal framework. The following part (Section 1.2) presents statutory disclosure rules, and Section 2 explores the operation of private enforcement within the framework of common law and the statutory provisions contained in Sections 90 and 90A of the FSMA 2000. The collective actions for claimants are further discussed in Section 3, along with other procedural restrictions that can keep claimants from participating in court. Section 4 evaluates the complementarity between private securities litigation and public enforcement led by FCA and explains the how the current securities-enforcement structure has developed.

1.2 Mandatory Disclosure

The main goal of securities regulation is to protect investors by ensuring they have access to accurate and thorough information so they can make informed investment decisions.[355] In the U.K., issuers therefore have a statutory duty to make mandatory disclosures to investors, and securities regulation imposes duties to provide a compliant prospectus and to make continuing disclosures.[356]

1.2.1 Prospectus Disclosure

[355] See Chapter I Section 1.1.

[356] Ibid.

Before offering transferable securities on the public market, issuers must provide a prospectus (FSMA 2000 Section 87A). In the prospectus, the issuer must disclose required information[357] related to the assessment of the securities,[358] and the prospectus must then be approved by the FCA.[359]

The duty of disclosure under Section 87A includes four elements. First of all, the duty to produce a prospectus is only imposed on issuers who wish to meet the FCA's admission requirements for an Official List or who are trading securities on a regulated market. If the prospectus is published for reasons other than compliance with Section 85, the duty in Section 87A does not apply. Second, the prospectus must pass the "informed assessment" test.[360] The test is flexible, but it aims to require the prospectus to contain material information necessary for a reasonable investor, which allows investors to be able to evaluate the issuer's financial status. To some extent, the test emphasises accessibility and conciseness,[361] rejecting excessive detail that could obscure key facts.[362] Thirdly, some specific issuer information must be disclosed. Section 87A pertains to the disclosure of issuer's financial

[357] FSMA 2000, s 87A(b).

[358] FSMA 2000, s 87A (2).

[359] FSMA 2000, s 85 ("It is unlawful for transferable securities to which this subsection applies to be offered to the public in the United Kingdom unless an approved prospectus has been made available to the public before the offer is made.") FSMA 2000, s 87A, or FSMA 2000, s 80 which covers a similar duty of disclosure of listing particulars.

[360] Since the reform, the "reasonable investor" test is no longer in use since the information is provided for all investors rather than investors and their professional advisers.

[361] FSMA 2000, s 87A (4).

[362] FSMA 2000, s 87A.

status, including their assets, liabilities, profits, losses, and future prospects. Finally, information on the securities' rights must be included in the prospectus. For example, the prospectus should detail whether there are more complex voting rights, compared to ordinary shares, attaching to the shareholder's right.

1.2.2 Continuing Transparency

Upon entering the public market, issuers are mandated to maintain continuing transparency by disclosing material information related to shareholders, controlling parties, and financial health.[363] This statutory duty of continuous disclosure ensures investors are empowered for informed decision-making throughout their investment lifecycle.

Firstly, the issuer must disclose information on shareholding, including "voteholder information," "voting rights" and any "notifiable change[s] in the proportion of [.…] voting rights."[364] "Voteholder" refers to "information relating to the proportion of voting rights held by a person in respect of the shares."[365] Based on shareholder registration, the public also needs to know who substantially controls the issuer ("voting rights"). The last head simply

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[363] These transparency requirements are set out in CA 2006, pt 43. Furthermore, the FCA regulates transparency rules under the Disclosure Guidance and Transparency Rules ('DTR'), as it has delegated administrative authority to collect information with regard to securities markets.

[364] FSMA 2000, s 89B.

[365] FSMA 2000, s 89B (3).

means that the issuer must notify the public once a change in voting rights occurs.

Second, the issuer must disclose its financial and securities status, which includes periodic accounting, loan, grantee information, and the rights that come with securities.[366] Under the Disclosure Guidance and Transparency Rules in the *FCA Handbook*, "financial reports" refers to "an annual report," "a half-yearly report," or "an interim management statement." An annual report presents "an audited financial report"; "an interim management statement" is produced by those who are responsible for the annual report and provides an accurate financial representation of the issuer.[367] Like "a half-yearly report," it is drawn up by the issuer alone. "Interim management statements" should render public "material events and transactions" and "a general description of the financial position and performance of the issuer and its controlled undertakings."[368]

Thirdly, under the *FCA Handbook* Listing Rules, the issuer must notify the public of any real-time material information. The rule states that "timely and accurate disclosure of information to the market is a key duty of listed companies."[369] For example, the issuer must make public any inside

[366] FSMA 2000, s 89C.

[367] Transparency Directive, art 4(2)(c).

[368] FSMA 2000, s 89C(4)(b).

[369] *FCA Handbook*, Listing Rules (LR) 7.2.3G.

information that is pertinent to them,[370] such that all investors have the same decision-making information simultaneously. Furthermore, this information must be disclosed by the issuer promptly.[371]

2. Substantive Elements in Common Law and FSMA 2000

This Section will discuss the causes of action for harmed investors against issuers and other responsible parties for disclosures that are material misstatements or omissions. There are two statutory actions that are available to investors but causes of action in common law are also relevant. Here, this Section first discusses the common law of Misrepresentation under the Tort of Negligence. This action is important as a foundation to discuss statutory actions under Section 90, and Section 90A, FSMA 2000. This Section then discusses the common law tort of deceit as an alternative to statutory actions.

[370] *FCA Handbook*, DTR 2.2.4.

[371] *FCA Handbook*, DTR 2.2.1A. However, the issuer is exempted from disclosing "inside information" in order to protect its legitimate interests. *FCA Handbook*, DTR 2.5.1R. Directive 2014/57/EU of the European Parliament and of the Council of 16 April 2014 on criminal sanctions for market abuse [2014] OJ L173/179 (Market Abuse Directive), art 6(1).

<table>
<tr><th></th><th>Misrepresentation under the Tort of Negligence</th><th>Section 90 under FSMA</th><th>Misrepresentation under the Tort of Deceit</th><th>Section 90A under FSMA</th></tr>
<tr><td>Legal Nature of Cause of Action</td><td>Common Law Liability</td><td>Statutory Liability</td><td>Common Law Liability</td><td>Statutory Liability</td></tr>
<tr><td>Claimants</td><td>Investors in Primary Market and Secondary Market</td><td>Investors in Primary Market and Secondary Market</td><td rowspan="2">It continues to hold relevance in the securities market, particularly in scenarios where liability claims fall outside the scope of statutory provisions under Section 90A</td><td>Investors in Secondary Market</td></tr>
<tr><td>Persons Responsible</td><td>Caparo Test (Proximity)</td><td>Limited to Issuer and Their Responsible Officers</td><td>Limited to Issuer</td></tr>
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<tr><td>Defense</td><td>-</td><td>Schedule 10</td><td>-</td><td>Schedule 10A</td></tr>
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Figure 1: Table Comparing Key elements of Statutory and Common Law Causes of Action in Private Securities Litigation

2.1 Misrepresentation under Tort of Negligence

Misrepresentation under Tort of Negligence is the common law foundation for persons suing for pure economic loss based on material misstatements or omissions. The development of this cause of action had to address how to claim for pure economic loss. Next, the traditional interpretation of duty of care needed to be adapted to the securities market. Finally, statutory actions build upon but improve on the common law action, such as by reducing the claimant’s burden of proving reliance, which is the most difficult element to prove.

2.1.1 Pure Economic Loss Doctrine

Compensation for pure economic loss has come a long way in civil liability development. The norm for a long time is that tortious liability covers only property damage or physical injury. The failure to secure financial benefit is described as "pure economic loss."[372] In principle, judges have been reluctant to compensate pure economic loss in tort cases.[373]

In *Cattle*,[374] the claimant was a tunnelling constructor. The claimant said that their work site was flooded as a result of the defendant's third-party conduct, which forced them to postpone their work and pay additional costs. The claimant sought compensation to recover the financial losses they had sustained.[375] Blackburn J ruled that Stockton had no responsibility for the loss incurred to the constructor as they had not intended to damage the claimant's tunnelling project. Thus, the claimant was not eligible to receive compensation for the losses.[376] Moreover, in *Weller*,[377] the claimants were about to sell off their cattle. However, a foot-and-mouth-disease quarantine forced them to shut down their cattle auction. The claimants claimed compensation. The court reasoned that allowing pure economic loss to be

[372] Carol Brennan, *Tort law* (8th edn, OUP 2022) 122; see also *Spartan Steel and Alloys Ltd v Martin & Co* [1973] QB 27.

[373] Mark Lunney, Donal Nolan, and Ken Oliphant, *Tort Law: Text and Materials* (6th edn, OUP 2017) 381.

[374] *Cattle v Stockton Waterworks Co* [1875] LR 10 QB 453.

[375] Ibid; see also *Simpson v Thompson* [1877] 3 App Cas 279.

[376] *Cattle v Stockton*, note 374, 457.

[377] *Weller & Co v Foot and Mouth Disease Research Institute* [1966] 1 QB 569.

recoverable in such circumstances risked triggering an overwhelming influx of negligence-based litigation.[378]

This exclusionary principle has been justified on multiple occasions. McLachlin J concluded that the broad approach in *Anns*[379] could lead more uncertainty in the tort of negligence. Imposing liability for potential economic risks on a party without affording them a corresponding opportunity to share in the activity's benefits would be inequitable.[380] Moreover, the claimant is arguably in a dominant position to foresee an accident that may cause economic loss or control the impact of such losses, which should perhaps not be claimed from a third party. The claimant may purchase insurance or negotiate a remedy term in the contract; neither of these is feasible for the third party.[381]

However, the House of Lords began to recognise actionable economic losses where fraudulent misrepresentations were made. In *Derry v Peek*,[382] the prospectus outlined the company's strategic shift from relying on horses to adopting mechanised vehicles as a means of accelerating business growth.

[378] Carol Brennan (2022), note 372, 124.

[379] *Anns v Merton London Borough Council* [1977] UKHL 4, [1978] AC 728. The House of Lords established a widely applicable definition of the tort of negligence by lowering the threshold of recognising a duty of care. This ruling has established a "general principle" (known as the 'Anns Test') so that a lawsuit for economic loss can usually be brought forward.

[380] W Bishop, 'Economic Loss in Tort' (1982) 2 OJLS 1, 19-24.

[381] Ibid.

[382] *Derry v Peek* [1889] 14 App Cas 337.

Unfortunately, the company failed to make such a technical innovation, as it failed to secure government approval to possess vehicles. Based on the prospectus, the claimants purchased shares and claimed compensation. Lord Bramwell declared that if the directors were not acting in a fraudulent manner, they could not be accountable for false statements made in the prospectus.[383] This meant that those bringing a legal action had to demonstrate that the misstatements made in a prospectus were fraudulent and made dishonestly.

2.1.2 Pure Economic Loss in Tort of Negligence

Lord Denning MR contended that the court's persistent adherence to the exclusionary principle stemmed from either the absence of a duty of care[384] owed by the defendant or the causal connection being too attenuated[385] to establish legal liability.[386] Despite this, subsequent advancements have opened up the possibility for courts to acknowledge a duty of care for pure economic loss arising from negligently made false or misleading information.[387]

[383] Ibid [347].

[384] Eg In *Inland Revenue Comrs v Hambrook* [1956] 2 QB 656.

[385] Eg In *King v Phillips* [1953] 1 QB 429; Clarence Morris, 'Duty, Negligence and Causation' (1952) 101 University of Pennsylvania Law Review 189-222.

[386] Carol Brennan (2022), note 372, 125.

[387] Carol Brennan (2022), note 372, 129.

In *Hedley*, [388] the court reevaluated the necessity of providing compensation for pure economic loss. The claimant asked Easipower's bank (Heller & Partners) for a financial report. After reviewing the financial report, the claimant made the decision to establish a business relationship with Easipower. Since the claimants have relied on the report, they suffered economic losses totalling £17,000. The court determined that in situations where there is close proximity between two parties, a duty of care may be owed and proximate causation for any resulting damage could result in tortious liability, even if the misstatement made was not fraudulent but only negligent.[389]

Hedley became authority for the key legal element of a proximate relationship between the claimant and defendant who made the alleged misstatement. For example, in *JEB*,[390] the claimant (who had suffered an unprofitable takeover bid) did establish that the target company's auditors owed a duty of care based on a proximate relationship (although the claimant failed as it was unable to show that they relied on the accounts causing their loss).[391]

[388] *Hedley Byrne v Heller & Partners Ltd* [1963] UKHL 4, [1964] AC 465.

[389] Ibid [473].

[390] *JEB Fasteners v Marks Bloom & Co* [1983] 1 All ER 583.

[391] Carol Brennan (2022), note 372, 132.

2.1.3 Expansive Interpretation of the Duty of Care

To invoke the *Hedley* test and establish a duty of care, the claimant must demonstrate: (1) reliance on the defendant's representation or advice; (2) the defendant's awareness (or reasonable foreseeability) of such reliance; and (3) that such reliance was objectively reasonable under the circumstances.[392] Crucially, this test establishes the elements for a direct and proximate relationship between the parties at the time the statement was communicated. A duty of care arises only when such a sufficiently proximate relationship is present, ensuring liability is confined to scenarios where the defendant could reasonably anticipate reliance on their expertise or assurances.

In *Caparo*,[393] the court clarified the meaning of "proximate relationship." In this case, the claimant decided to make a takeover bid and purchased shares in the target company, Fidelity. Caparo found that the financial report of the target company indicated a profit of £1.2 million. However, it was discovered that the public financial records were inaccurate, and the target firm had really lost £400,000 rather than made a profit. To recover its monetary damages, Caparo took the target company's auditors to court. While the court determined that in this particular case, the auditors had no duty of care, the case refined the criteria for determining such duties, highlighting that

[392] *Hedley,* note 388, 492.

[393] *Caparo Industries Plc v Dickman* [1990] UKHL 2, [1990] 2 AC 605.

establishing proximity—a direct and foreseeable relationship between parties—is a necessary precondition for liability. This meant that the representor had a purpose in making the statement, had knowledge of the situation, and the representee relied on the statement.[394]

Specifically, in a scenario where the representor knows his statement is provided to the representee for a given purpose, there is a duty of care if the representee relies on that statement and consequently suffers damage. For example, in *Morgan Crucible Co Plc v Hill Samuel Bank Ltd*,[395] the court found that the entity making the statement to the party launching the takeover offer had a duty of care, which was violated.[396] The divergent outcomes in *Morgan* and *Caparo* hinged on the statement's intent and audience: in *Caparo*, at the time the statement was issued, there was no identifiable bidder, whereas in *Morgan*, the statement was crafted with the explicit intent to mislead a specific bidder.[397]

Under the common law, in a case where a prospectus is inaccurate, the *Caparo* test cannot protect claimants to whom the prospectus is not purposely directed. That is, the purchasers of securities must be such that the issuer could reasonably foresee their reliance on the prospectus. In other words, a

[394] Ibid.

[395] *Morgan Crucible Co Plc v Hill Samuel Bank Ltd* [1990] EWCA Civ 4, [1991] Ch 259.

[396] Ibid.

[397] Ibid.

duty of care would likely not be established for individuals who buy after-market securities.[398]

However, *Possfund* found such proximity.[399] In *Possfund*, the defendant issued a prospectus for shares on an unlisted securities market. It was later discovered that the prospectus underestimated the issuer's liabilities, which caused the defendant losses in business. The claimants, encompassing investors who acquired shares through secondary market transactions, alleged that the defendant violated legal duties under both fraudulent misrepresentation (deceit) and negligence. In this case, one controversial issue was whether proximity existed between the after-market purchasers and the maker of the prospectus. According to Lightman J's ruling, if the prospectus was issued with the intent of encouraging the public to purchase shares, a duty of care existed in favour of immediate aftermarket purchasers who could reasonably be foreseen to rely on the prospectus.[400]

It should be noted that such a duty of care based on the prospectus in *Possfund* would "fade away" for aftermarket purchasers to a certain degree, as time passes after the initial public offering (IPO). The longer the time elapsed between the IPO and the secondary market claimant's purchase of the

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[398] *Al-Nakib Investments (Jersey) Ltd v Longcroft* [1990] 3 All ER 321. See also Mark Lunney, Donal Nolan (2017), note 373, 435.

[399] *Possfund Custodian Trustee Ltd v Diamond* [1996] 2 All ER 774.

[400] Ibid [1364-1365].

securities, the more likely it is that new factors will have emerged to dilute the claimant's reliance on the original prospectus.[401] Further, such a relationship only exists in cases where the statement is in the prospectus and does not necessarily apply to other types of statements.

2.1.4 Reliance in Common Law

Under the common law action of negligence for misstatements, *Possfund* shows that the representee must demonstrate that they reasonably relied on it and have a belief that the representor has an intention for him to invest.[402] Here, reliance always was the factor causing the claimant to fail in the trial.

In the case of *Al-Nakib*, the court clarified the standard for "the representor should intend for the representee to rely on the representation." In this case, the defendant company issued a prospectus, and the claimants purchased the company's shares as subscribers, relying on the statement in the prospectus. The court held that the defendant company's duty of care extended solely to a defined subset of subscribers, excluding investors who acquired securities in secondary markets. As a result, the court concluded there was no breach of duty or liability for fraudulent misrepresentation.[403]

[401] Alastair Hudson, *Securities law* (2nd edn, Sweet & Maxwell 2013) 23. This also could be interpreted by the element of causation. Davies P et al., *Gower*: *Principles of Modern Company Law* (11th edn, Seet & Maxwell 2021) 25-34.

[402] *Possfund*, note 399.

[403] *Al-Nakib Investments (Jersey) Ltd*, note 398.

However, in *Possfund*, which involved claimants who purchased securities in the secondary market, Lightman J. held that providing a prospectus should not be limited to statements intended for specific investors. This should be extended to investors in the immediate after-market who would reasonably act based on the prospectus.[404] Therefore, in contrast to *Al-Nakib*, the decision in *Possfund* reaffirmed the possibility of common-law reliance rather than expanding its scope.

2.1.5 The Duty of Care Owed by Underwriters

Since Section 90 of the FSMA 2000 does not apply to underwriters where a misrepresentation is found during an IPO (as will be discussed in Section 2.2.2), a question arises as to whether a duty of care in relation to prospectuses can also be owed by underwriters, in addition to issuers. That is, can the common law provide a cause of action for investors to sue underwriters, subject to the existence of a proximate relationship with investors? The answer proposed in this study is yes.

In *Caparo*, although the claimant did not successfully establish such a relationship with the issuer's accounting firm, *Caparo's* holding does not deny the possibility to establish such a relationship with underwriters.

[404] *Possfund*, note 399.

Firstly, the accounting firm (as in the *Caparo* case) may not have been able to predict that their accounting report would be an important reference factor for the claimant's purchase of issuer's securities.[405] The report was chiefly produced for the company's use. In an IPO, underwriters serve a critical function by orchestrating the offering process and facilitating the issuing company's entry into public markets through the distribution of shares to institutional and retail investors.[406] The key performance of the underwriter is sales and distribution, which means that underwriters market the shares to investors and coordinate the sale and distribution of the shares.[407] Therefore, the role of underwriters is clearly different from that of accounting firms in *Caparo*. In other words, *Caparo's* holding does not deny the possibility of underwriters assuming responsibility, since underwriters work in the external-facing context.

Even if investors can establish a duty of care by the underwriters, the burden of demonstrating reliance must also be met by the claimant, who must provide proof that the defendant's actions or conduct had a direct impact on their choices. The reliance requirement can be proven[408] by demonstrating

[405] Ibid.

[406] Roger G Ibbotson and Jay R Ritter, 'Initial Public Offerings' in R Jarrow et al. (eds), *Handbooks in Operations Research and Management Science*, vol 9 (Elsevier 1995) ch 30.

[407] Christopher J Mier, 'The Role of the Underwriter' in Sylvan G Feldstein and Frank J Fabozzi (eds), *The Handbook of Municipal Bonds* (Wiley 2012) ch 14.

[408] *Possfund*, note 399.

both (1) reasonable reliance on the prospectus and (2) the underwriters' actual intent to induce such reliance, establishing that the defendants knowingly encouraged investors to depend on the accuracy of the disclosed information. Based on *Possfund*, the act of providing a prospectus can already be regarded as the responsible party subjectively hoping that the claimant will rely on the document.[409] Therefore, the claimant should only need to prove reliance on the prospectus, not necessarily reliance on the underwriter as such. Based on this, a claimant should be able to sue underwriters in an equivalent manner as issuers.

2.2 Statutory Liability for Negligent Misrepresentation under Section 90

2.2.1 The Elements of Section 90

Although the common law tort of negligent misstatements has been clarified and applied in precedent, statutory reform has arguably improved on this for investor protection. Under Section 90(1) of the FSMA 2000, individuals responsible for preparing listing particulars are liable to compensate any person who:(a) acquires securities covered by those particulars; and(b) suffers losses attributable to either: (i) untrue or misleading

[409] Ibid.

statements in the particulars; or (ii) omissions of information required to be disclosed under Sections 80 or 81 of the FSMA 2000.[410]

2.2.2 Parties Responsible

PRR 5.3 of the Prospectus Regulation Rules (PRR) specifies the parties responsible for a prospectus when equity shares are offered.[411] These include: the issuer of the transferable securities; directors of the corporate entity; senior executives of external management entities; any party formally accepting responsibility for the prospectus; the offeror (if distinct from the issuer); the party requesting admission to trading (if distinct from the issuer). All listed parties are held legally accountable for the accuracy and completeness of the prospectus. Additionally, any individual or entity that authorises the prospectus content—even if not explicitly listed above—assumes accountability for its accuracy.

A question is whether underwriters can be held liable under Section 90.[412] This study argues that, from a systematic interpretation perspective, the "offeror" listed in Section 90 means the ambit of defendants includes

[410] FSMA 2000, s 90(1). Note that the "or" in s 90(1)(b)(i) means that an investor's loss could be caused by a statement being untrue or statement being misleading, or by a statement that is both untrue and misleading.

[411] *FCA Handbook: Prospectus Regulation Rules sourcebook,* PRR 5.3.

[412] Carsten Gerner-Beuerle, 'Underwriters, Auditors, and Other Usual Suspects: Elements of Third-Party Enforcement in US and European Securities Law' (2009) 6(4) JCLS 476, 495-496.

underwriters. However, in judicial practice, it may be difficult to hold underwriters accountable under Section 90.

Firstly, according to the Prospectus Regulation (EU), the definition of offeror means "a legal entity or individual which offers securities to the public."[413] Furthermore, "offers securities to the public" refers to "a communication to persons in any form and by any means, presenting sufficient information on the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe for those securities." It is worth noting that this definition covers "the placing of securities through financial intermediaries." Therefore, the meaning of offerors in Section 90 can include "financial intermediaries."[414] Underwriters function as financial intermediaries by acquiring securities directly from issuers and reselling them to investors, thereby facilitating the efficient issuance and distribution of these financial instruments.[415] Accordingly, an underwriter can be interpreted as a responsible person under Section 90.

[413] (EU) 2017/1129 Article 2 (i).

[414] (EU) 2017/1129 Article 2 (d).

[415] Eg Tomasz Piskorski, Amit Seru and James Witkin, 'Asset Quality Misrepresentation by Financial Intermediaries: Evidence from the RMBS Market' (2015) 70(6) Journal of Finance 2635-2678; Steven Drucker and Manju Puri, 'On the Benefits of Concurrent Lending and Underwriting' (2005) 60(6) Journal of Finance 2763-2799; Franklin Allen and Anthony M Santomero, 'What Do Financial Intermediaries Do?' (2001) 25(2) Journal of Banking and Finance 271-294; Richard B Carter, 'Underwriter Reputation and Repetitive Public Offerings' (1992) 15(4) Journal of Financial Research 341-354.

However, although underwriters are considered offerors, if we consider PRR 5.5.7, underwriters can hardly be held liable under Section 90. According to PRR 5.5.7, it discusses Section 90 that pertains to the responsibility of individuals involved in the issuance of a prospectus. PRR 5.5.7 establishes that an offeror may be shielded from liability for a prospectus provided the following criteria are met: (1) Responsibility of the Issuer: The issuer assumes accountability for the prospectus under the compliance standards prescribed in this section. (2) Preparation by the Issuer: The prospectus was predominantly authored by the issuer or its authorised agents. (3) Collaborative Arrangement: The offeror operates in a legally recognised collaborative framework with the issuer.[416]

This framework establishes that underwriters, acting as offerors, are shielded from liability under Section 90 of the FSMA 2000 since: (a) The issuer bears direct responsibility for false or misleading statements in the prospectus; or (b) The issuer actively and collaboratively participated in preparing or drafting the prospectus. Such protections are codified under PRR 5.5.7. Judicial precedents confirm that these criteria are frequently invoked in litigation, reflecting common scenarios where issuers—not underwriters—are held accountable for prospectus inaccuracies.

[416] *FCA Handbook: Prospectus Regulation Rules sourcebook*, PRR 5.5.7.

Hence, underwriters generally do not assume responsibility when Section 90 is applied, but claimants may seek remedy through Misrepresentation under Tort of Negligence, as discussed in Section 2.1.5.

2.2.3 Defence[417]

Section 90 does not require the defendant who are listed in Section 2.2.2 to have fraudulent intentions or negligent conduct. Section 90 is a statutory action for investors based on the untrue, misleading, or omitted prospectus content. However, it is not strict liability.[418] Schedule 10 of the FSMA 2000 stipulates that if the issuer reasonably believes that their statement is accurate and will not mislead, or if the omission is deemed to be reasonable, they won't be liable under Section 90. In Section 90, primary subscribers to securities can bring a civil action for misstatements or omissions, but due to the operation of the defence above, it seems that a negligence standard applies for such misstatements and omissions. Nonetheless, the burden of providing proof rests with the issuer, hence being more investor-friendly than suing under the common law. The nature of Section 90 could be interpreted as a negligence-based statutory liability with a reverse burden of proof.[419]

[417] Section 90 does require claimants to prove the state of mind of the defendant.

[418] Strict liability refers to the issuer liability under section 11 of Securities Act 1933. See Chapter II Section 2.2.1.

[419] Paul Davies, 'Liability for Misstatements to the Market' (2010) 5(4) Capital Markets Law Journal 443, 444.

However, in some situations, investors may also have to show whether they have the standing to bring a Section 90 action, such as if they are aftermarket purchasers, as *Possfund* discussed. It can be argued that the statutory action should be no less favourable than that provided under common law. However, as the statutory and common law actions require different legal elements, it can also be argued that the question need not be shaped by *Possfund.*

Further, Section 90 requires investors to prove causation for the loss. Similarly, in common law, persons suffering pure economic loss need to prove the causation between negligent conduct and an economic loss. Therefore, how to interpret causation for the loss under Section 90 could be referenced to common law precedents.

Similar concepts have long been established between common law and section 90, although judicial clarification on their cross-fertilisation would be useful. However, to date, there has been limited litigation under Section 90.

2.2.4 Reliance: Not Required

The key difference between common law and the statutory action in Section 90 is that claimants need not show reliance on the alleged misstatement.

In Section 90, claimants need only show that they have purchased the securities and that the prospectus or listing particulars involved an untrue or misleading representation or omission.[420] In other words, the statutory liability under Section 90 does not require claimants to prove reliance.[421] This statutory liability fundamentally eases the difficulty that the claimants would have faced in showing that each of them had read the specific misrepresentation and made a decision to purchase securities on this basis. It is much easier for the claimant to establish transaction causation.

2.2.5 Loss Causation

Loss causation, distinct from transaction causation, requires demonstrating a direct causal connection between the misrepresentation and the investor's financial loss. While Section 90 eliminates the need for claimants to prove transaction causation (i.e., reliance on the misrepresentation), it mandates proof of loss causation. Specifically, the statute holds parties responsible for listing particulars liable to compensate individuals who: (a) acquired securities covered by the particulars; and (b) suffered losses directly attributable to: (i) false or misleading statements in the particulars; or (ii) omissions of required information.[422]

[420] Alastair Hudson (2003), note 401, 23.

[421] Eg PS Atiyah, 'Res Ipsa Loquitur in England and Australia' (1972) 35 MLR 337, 344.

[422] FSMA 2000, s 90 (1) (a) and 90 (1) (b).

2.2.6 The Effectiveness of Section 90

In dealing with the issue of false statements in prospectuses, legislators chose to use legislative means to protect investors because they recognised the inadequacies of common law remedies for investor protection.[423]

The integration of statutory frameworks to augment common law protections for investors began in the late 19th century. In *Derry v. Peek*, redress for prospectus misstatements was confined to the tort of deceit, which necessitated proof of the defendant's fraudulent intent to deceive.[424] Dissatisfaction with this restrictive ruling prompted Parliament to pass the Directors Liability Act 1890, which legislatively "extended" *Derry*'s precedent.[425] The Act imposed a statutory duty of care on issuers, directors, and others responsible for prospectus content, allowing investors to seek damages for losses brought on by false statements if they subscribed on the faith of the prospectus. Crucially, the Act reversed the burden of proof by requiring defendants to demonstrate that they had exercised due diligence, rather than obliging claimants to establish fraudulent intent — a structure later mirrored in Section 90.[426]

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[423] *Possfund*, note 399.

[424] *Derry v Peek,* note 382.

[425] Paul Davies (2010), note 419, 444.

[426] Directors Liability Act 1890 (53 & 54 Vict. c. 64). Unless they prove that they had reasonable grounds to believe the statement was true and did believe so.

The question of whether legislative supplementation of common law remedies was necessary arose again a century later. This regulatory shift was driven by the advanced state of 20th-century securities markets and the influence of EU directives, which obligated U.K. lawmakers to rigorously address accountability mechanisms for inaccurate or fraudulent disclosures in prospectuses.[427] Therefore, after the *Possfund*, legislators realised that current remedies for false statements in prospectuses were insufficient for investors. The new Section 90 should be interpreted as more favourable to investors than previous common law and related legislation, because it broadens the range of standing to sue, provides constructive knowledge, and does not require proof of reliance.

Although, judicial interpretation of Section 90 remains limited due to the lack of litigation, *The RBS Rights Issue Litigation* can be a good observation for the application of Section 90.[428] *RBS* was a high-profile legal case in the U.K. which concluded in 2019. The case involved a group of investors who claimed that the Royal Bank of Scotland (RBS) had made misleading statements in relation to a rights issue in 2008, causing them to suffer significant losses. In *RBS*, there was a £12 billion rights issue of RBS shares in 2008. RBS was accused of providing a prospectus that misrepresented the

[427] Eg Council Directive 2004/109/EC [2004] OJ L390/38.

[428] *The RBS Rights Issue Litigation* [2017] EWHC 463 (Ch).

true state of the bank's financial health, despite the fact that this rights issue was meant to enhance the bank's financial status amid the global financial crisis. Consequently, a significant number of investors who purchased rights issue shares sued RBS to recover damages, alleging that they had been deceived by the prospectus. In 2016, RBS agreed to a settlement of £800 million with the investors, thereby avoiding a second trial.

From the perspective of the current RBS case and the defendant's choice for a settlement, the application of Section 90 may mean that prospectus litigation can be quite powerful for investors. As investors are not required to prove negligence and reliance is presumed, listed issuers could be anxious about going to trial, and a settlement could be a best option to maintain their reputations. Since Section 90 is not strict liability, defendants may still incur effort and cost to show reasonable belief.

2.3 Misrepresentation under Tort of Deceit

We now turn to liability for continuing disclosure in the secondary market. Investors who purchased shares based on inaccurate continuing disclosure mainly look to Section 90A for establishing liability and compensation.[429] The concurrent existence of statutory and common law actions for secondary

[429] Eg Wai Yee Wan, 'Reconsidering Personal Liability of Directors and Senior Managers for Misstatements and Non-Disclosures to the Securities Market' (2009) 9(1) Journal of Corporate Law Studies 235-255.

market disclosure remains important since Section 90A only limitedly caters for investor protection due to restrictions in Paragraphs 7(1) and 7(2) of Schedule 10A. The following discussion will argue the tort of deceit whose principles and effectiveness remain relevant in addressing the “loopholes” left by Section 90A.

2.3.1 The Effectiveness of Misrepresentation under Tort of Deceit

Common law remedies remain an essential complement to the statutory causes of action under the FSMA 2000, especially in respect of continuing disclosure obligations in the secondary market.

Paragraphs 7(1) and 7(2) of Schedule 10A circumscribe the scope of civil liability under Section 90A. Paragraph 7(1) provides that an issuer’s only liability for misleading statements, omissions or delayed disclosures is that which is expressly created by the FSMA 2000 provisions themselves, thereby excluding any parallel common-law claims (for example, negligence or deceit) by investors against the issuer. Likewise, Paragraph 7(2) bars investors from suing third parties such as directors or auditors directly—unless the issuer later seeks contribution or indemnity from them.

Those exclusions, however, are not without exception. Paragraph 7(3) makes clear that nothing in Paragraphs 7(1) or 7(2) is intended to exclude other civil, regulatory or criminal liabilities which might arise under general law. In particular, Paragraph 7(3)(a)(v) preserves liability whenever a person has "assumed responsibility" to another for the accuracy or completeness of information provided for a specific purpose.

The accompanying explanatory materials underscore this point: legislation states that Paragraph 7(3)(a)(v) is "intended to ensure that an issuer will remain liable for negligent misstatements where such liability would exist under the rule in *Caparo*, as subsequently developed by the courts."[430] Under *Caparo*, a duty of care—and thus potential liability—arises where negligent advice is given (or information supplied) to a known recipient for a defined purpose, the adviser is aware of the recipient's reliance, and the recipient does in fact rely to their detriment. In short, if a defendant has assumed responsibility for the accuracy of information and that information is negligently incorrect, causing economic loss, a claim for negligent misrepresentation remains available despite the general restrictions in Paragraphs 7(1) and 7(2).

Although the legislative materials refer only to negligent misstatements (Caparo), it makes sense—using the a fortiori principle—to include fraudulent misrepresentation as well. In other words, if the legislature chose to protect investors who suffer because of careless or negligent advice, then

[430] HM Treasury, *Extension of the Statutory Regime for Issuer Liability: A Response to Consultation* (March 2010) para 6.31.

it follows with even greater force that those who suffer from intentional lies should be protected too. Therefore, when construing Paragraph 7(3)(a)(v), one should interpret it as preserving common-law remedies for both negligent and fraudulent misrepresentations (Misrepresentation of Tort of Deceit).

Therefore, it is arguable that although Section 90A restricts investor claims to actions against the issuer under statutory terms, it does not preclude claimants from retaining the ability to pursue legal action against third parties—such as company directors, advisors, or other entities not directly issuing securities (non-issuers)—under the Misrepresentation of Tort of Deceit. This demonstrates that the Misrepresentation of Tort of Deceit continues to hold relevance in the securities market, particularly in scenarios where liability claims fall outside the scope of statutory provisions under Section 90A. By invoking the Misrepresentation of Tort of Deceit, claimants can address misstatements made by parties other than the issuing entity itself, ensuring accountability even when statutory remedies under securities-specific laws do not apply.[431]

2.3.2 The Definition of Deceit

[431] Ibid.

A common challenge in litigation involves determining the defendant's mental state. Under the common law tort of deceit, the claimant must demonstrate that the defendant acted with intentional deceit in order to establish liability.

In *Derry*,[432] Lord Herschell discussed the meaning of deceit, determining that the company's directors were responsible for the prospectus's misrepresentation. The court held that establishing a deceit claim requires the claimant to prove the defendant acted with fraudulent intent—specifically, that they knowingly made a misstatement or omitted material facts with the deliberate aim to mislead. Lord Herschell further articulated this standard, emphasising the necessity of intentional dishonesty to sustain such a claim. The legal principles regarding the tort of deceit requires are: (1) Firstly, to bring an action of deceit, it is essential to demonstrate fraud, and no other standard of proof will be acceptable. (2) Second, in order to prove fraud, it has to show that a false representation was made either: (i) knowingly, (ii) without a belief in its truth, or (iii) recklessly, with no concern for its accuracy or falsehood. To avoid being deemed fraudulent, it is necessary to hold an honest belief in its veracity.[433]

[432] *Derry v Peek,* note 382.

[433] Ibid [376].

2.3.3 Honest Belief Defence [434]

In addition, the defendant may put forward the argument that they held an honest belief in the accuracy of their statement, which would render fraud unable to be proven. "Honesty" may be interpreted in two ways: either it suggests that the defendant should have acted as any honest person would or that the defendant should have acted as the defendant in a given circumstance. In the case law, the former interpretation of honesty is called an objective test[435] and, by contrast, the latter is called a subjective test.[436]

A means of determining whether a particular mental state constitutes an "honest belief" within the context of securities regulation is outlined in *Akerhielm*.[437] In *Akerhielm*, a prospectus was made for fundraising purposes for a private company producing "cold process" tiles. The prospectus stated that a one-third subscription of shares had been carried out in Denmark. However, it was discovered that the prospectus was false, despite the defendant believing it to be accurate. As a result, investors suffered economic loss and brought a claim suing the defendant for fraudulent misrepresentations. In *Akerhielm*, it was argued that the court should assess

[434] John Cartwright, *Misrepresentation, Mistake and Non-disclosure* (2nd edn, Sweet & Maxwell 2007) 5.15. See also recklessness in torts in *Derry v Peek* (note 382). See honest belief and reasonable belief in *Beckford v R* [1988] AC 130. See the existence of an honest belief without reasonable grounds in *R v Williams (Gladstone)* [1983] 78 Cr App R 276, 281. See *mens rea* defence in *Director of Public Prosecutions v Morgan* [1976] AC 182.

[435] *Royal Brunei Airlines v Tan* [1995] 2 AC 378

[436] *Twinsectra Ltd v Yardley* [2002] UKHL 12, [2002] 2 All ER 377.

[437] *Akerhielm v De Mare* [1959] AC 789.

whether the defendant held an honest belief in the accuracy of their statement when making it, rather than taking an objective test. In this case, it was determined that the statement was not fraudulent, as the directors had a valid reason for making the misrepresentation and had an honest belief that it was true.[438]

2.3.4 Reliance in Common Law

Similar to the reliance requirement in Misrepresentation under Tort of Negligence, the Misrepresentation under Tort of Deceit in securities litigation also requires that claimants prove they relied on misstatements related to the securities when purchasing them. If claimants cannot prove they relied on the statements or information, they will not be able to meet the burden of proof for causation. Claimants must demonstrate that their investment was motivated by the defendant's facts or representations rather than by other considerations and that they reasonably relied on the defendants misleading statements.[439] Additionally, , unlike actions for Misrepresentation under Tort of Negligence, the claimant needs to prove that the defendant intentionally deceived them, causing the claimant to invest.

[438] Ibid [790]. Notably, the U.S. approach (scienter) likewise allows genuine honest belief to negate the knowledge/falsity/recklessness element, but many US courts are less forgiving of beliefs that are utterly unreasonable (they may treat them as recklessness). *United States ex rel. Schutte v. Supervalu Inc.*, 598 U.S. 739 (2023).

[439] *Peek v Gurney* [1873] LR 6 HL 377.

2.4 Statutory Liability for Tort of Deceit under Section 90A

2.4.1 The Elements of Section 90A

Section 90A of the FSMA 2000 addresses liability for issuer's mandatory disclosure duty to provide continuing information.[440] Whereas Section 90 regulates listing particulars or a prospectus, Section 90A covers untrue and misleading information made in "annual financial reports," "half-yearly financial reports," "interim management statements," any "pre-release statement," or statement made prior to the publication of the full report.[441]

In terms of legislative intent, Section 90A departs from the case law Misrepresentation under Tort of Negligence, affirming that in Section 90A, the responsible issuer cannot be held liable merely for being negligent. Additionally, Section 90A adopts and adapts the prior common law principles regarding the tort of deceit.[442] In other words, the understanding of Section 90A cannot disregard the role of the common law tort of deceit in its interpretation, but this also makes investor litigation much more challenging.

Under Schedule 10A of the FSMA 2000, securities issuers are liable to compensate individuals who: (1) purchased, retained, or sold securities in reliance on information published under this Schedule; and (2) suffered losses

[440] Paul Davies (2010), note 419, 444.

[441] *FCA Handbook*, DTR 4.2.

[442] Paul Davies, *Davies Review of Issuer Liability* (HM Treasury 2007) 6.

attributable to: (i) untrue or misleading statements in such information; or (ii) material omissions of information required to be disclosed under this Schedule.[443]

Moreover, "[t]he issuer is liable in respect of an untrue or misleading statement only if a person discharging managerial responsibilities within the issuer knew the statement to be untrue or misleading or was reckless as to whether it was untrue or misleading."[444] For omissions, the Schedule also imposed a similar exemption for issuers: "The issuer is liable in respect of the omission of any matter required to be included in published information only if a person discharging managerial responsibilities within the issuer knew the omission to be a dishonest concealment of a material fact."[445] The wording arguably aligns with the dishonesty in belief standard in the tort of deceit, with clarification that reckless indifference to the veracity of a statement is

[443] FSMA 2000, sch 10A (3)(1). Other than untrue and misleading statements, Schedule 10A also imposes liability on the issuer for dishonest delay, see FSMA 2000, sch 10A (3)(2). In terms of the scope of claimants, the case law clarifies that ultimate investors, despite holding securities indirectly, can seek redress for reliance on false information. In *Omers*, Section 90A allows investors to claim damages for losses caused by reliance on misleading information published by companies. It extends to those who acquire, hold, or dispose of securities based on such information. Tesco contended that indirect holders via CREST did not meet the statutory requirements. However, Mr. Justice Hildyard ruled that the statutory language was intentionally broad and that holders of intermediated securities have an equitable proprietary right in the securities, making them eligible to claim. *Omers Administration Corporation and others v. Tesco PLC* [2019] EWHC 109 (Ch).

[444] FSMA 2000, sch 10A (3)(2). In *Allianz*, Mr Justice Miles ruled that the term PDMR under Section 90A FSMA should not be construed in line with its broader definition in European financial regulation. He rejected the claimants' argument that PDMR had an autonomous meaning under EU law, pointing out that the term was defined in the 2004 Commission Directive and implemented into UK law to cover senior executives with decision-making powers. However, Section 90A FSMA was designed to promote market efficiency and investor protection under the Transparency Obligations Directive, which did not reference PDMR, supporting a narrower definition. *Allianz Global Investors GmbH v G4S Limited* [2022] EWHC 1081 (Ch).

[445] FSMA 2000, sch 10A (3)(3).

also dishonest, a conclusion supported by a range of other general case law defining "dishonesty in belief."[446]

2.4.2 Reliance in Circumstance

2.4.2.1 Reasonable Reliance

The claimant must be able, by the time the securities have been purchased, to show reliance on the misrepresentation. The defendant bears the burden of proving reliance under Section 90.[447] Section 90A does not reverse this burden of proof.

In case law, if the claimant wants to prove reliance regarding non-prospectus statements, the claimant needs to prove (1) reliance on false statements and (2) the defendant uses the misstatement to induce the claimant to invest.[448] In Schedule 10A Paragraph 3 (4), a person shall be "in reliance on the information in question, and did so at a time and in circumstances where it was reasonable for them to rely on it." Therefore, Schedule 10A's reliance requirement is arguably slightly different from under common law. Schedule 10A only requires the claimant to prove (1) reliance on false statements and (2) "at a time and in circumstances where it was reasonable

[446] *Derry v Peek,* note 382.

[447] The "fraud on the market" theory does not require claimants to prove their reliance on the misstatement, see *Basic*, note 205.

[448] *Peek v Gurney*, note 439.

for them to rely on it." Schedule 10A simplifies the claimant's burden by requiring proof only of objectively reasonable reliance on false statements under the circumstances—without mandating evidence of individualised or direct reliance.[449]

The reliance threshold under the FSMA 2000 was shaped by the U.K.'s legislative effort to align with EU investor protection standards, which generally favour private enforcement mechanisms. While the requirement to prove "dishonesty"—defined as knowledge or recklessness as to the falsity of the information—introduces a significantly higher fault threshold, the framework simultaneously offers claimants a more accessible reliance standard. Specifically, it adopts an objective test: whether a reasonable investor would have relied on the information in question, thereby removing the need for claimants to demonstrate their own subjective reliance.[450]

Notably, taken together, the U.K.'s approach represents a measured compromise. It gestures toward EU standards by easing the burden on reliance, but offsets this by preserving a demanding *mens rea* requirement. The result is a legal framework that acknowledges investor protection in form, while ensuring that private enforcement remains challenging in practice.

[449] Nahal, Hardeep S. '90A: Fuel for Litigation.' (2008) 28 Int'l Fin. L. Rev 39-41.

[450] Paul Davies (2010), note 419, 444.

ACL Netherlands BV marks the first High Court adjudication of a case under Section 90A of the FSMA 2000. Showing a reasonable reliance by investors is essential to proving issuers' responsibility under Section 90A and Schedule 10A. According to the court, the evaluation of reasonableness had to be based on the facts that were in place when the claimant relied on the statement. The test is by its very nature fact-specific, based on the particulars of each situation. Moreover, the claimant needs to prove that the statement induced their investment decision. The court allows a "presumption of inducement" which helps the claimant's case in establishing reliance. However, the presumption requires that claimants were consciously aware (See Section 2.4.2.2) of the relevant statement or omission and that it prompted them to engage in the transaction.[451]

In the case of *Serco*, the court identified three types of reliance: direct reliance, market reliance and price reliance. Market reliance refers to investors making decisions based on the actual changes in stock prices in the market, including buying, holding or selling stocks. Price reliance refers to relying on changes in stock prices when investors know that both the stock price and the published information are true, complete, and accurate. If the claimant alleges direct reliance, it is limited to relying on the defendant's published information as a whole, not on individual statements within the

[451] *ACL Netherlands BV & Ors v Lynch & Ors* [2022] EWHC 1178 (Ch).

published information. Both market reliance and price reliance are forms of indirect reliance.[452]

Although the parties ultimately reached a settlement in June 2024, the court's reasoning could remain significant. The categorisation of direct and indirect reliance is intended to determine the applicability of the securities collective action (See 3.1.1). Based on the general requirement in the Civil Procedure Rules to adopt a preliminary substantive merits requirement in litigation,[453] court was prepared to consider indirect reliance rather than dismissing it altogether, showing that judicial interpretation may clarify the hitherto limited impressions of Section 90A.

However, another case illustrates that the interpretation of reliance under Section 90A may be confined to the common law framework. In *Allianz Funds Multi-Strategy Trust & Ors v Barclays Plc*, the High Court considered the issue of reliance in securities litigation under Section 90A. The claimants, including tracker funds, alleged that Barclays misled investors through false statements in its annual reports and prospectuses, resulting in financial losses. They argued that Barclays was liable under Section 90A for publishing misleading information.[454]

[452] *Various Claimants v Serco Group plc* [2023] EWHC 119 (Ch).

[453] Rachael Mulheron, 'The Case for an Opt-out Class Action for European Member States: A Legal and Empirical Analysis.' (2008) 15 Colum. J. Eur. L. 409, 411-412.

[454] *Allianz Funds Multi-Strategy Trust & Ors v Barclays Plc* [2024] EWHC 2710 (Ch).

The court focused on the legal requirement of "reliance" in the context of shareholder claims. Leech J ruled that to establish reliance on a misrepresentation, claimants must prove they read or heard the false statement. This interpretation aligns with the common law test of reliance used in tort of deceit claims. Leech J rejected broader, U.S.-style theories such as "fraud on the market" and emphasised that reliance is distinct from causation, serving as a separate element to limit liability. Since the tracker funds did not read or consider the relevant documents, their claims were dismissed.[455]

Leech J further clarified that, in cases of omission, it is unnecessary to prove reliance on the omitted information itself. Instead, the focus is on whether the claimant relied on the published statement from which the information was omitted. The judge added that the Court of Appeal may further develop the standard for reliance on implicit representations, which is still unclear.[456]

This ruling represents a significant limitation on the scope of securities litigation and may put to rest the possibility of interpreting reliance as indirect reliance. This is disadvantageous particularly for passive investors and shows

[455] Ibid [60].

[456] Ibid [57].

the necessity for claimants to demonstrate active engagement with the alleged misrepresentation.

2.4.2.2 Awareness in Reliance

In *Leeds*,[457] while the court further discussed the correct test for reliance, the court determined that the representee must have been conscious of the misstatement and comprehended it in the manner in which they subsequently raised a complain about it; in other words, the representation must have been actively present in their mind at the time of the transaction. The court noted that reliance may be established circumstantially, consistent with the statutory framework, but it remains a subjective inquiry into the claimant's actual state of mind. [458]

In *Leeds*, the claim was for the rescission of loans because the terms of these loans had been falsely influenced by the manipulation of LIBOR, the benchmark interest rate for the loans. The claimant argued that the defendant had engaged in LIBOR manipulation and had thereby illicitly profited from these loans. The defendant demanded that the case be struck out since the claimants lacked awareness and thus causation. It was a fact that when the

[457] *Leeds City Council & Others v Barclays Bank Plc & Another* [2021] EWHC 363 (Comm). Although *Leeds* was not a Section 90A case, the reasoning may nonetheless have implications for how Section 90A claimants establish to prove reliance. Here, in Tesco (Section 90A applied), Hildyard J said: "what is required [for reliance] is for there to be some description... [that] sufficiently identifies the particular statements or omission on which each claimant relied...why they took the statements to extend to [the matter] they have suggested, and how that impacted on their process of investment." *Various Claimants v Tesco plc* [2017] EWHC 3296 (Ch).

[458] Ibid [102].

claimants made a deal with the defendant, the claimants were not aware of how the LIBOR rate was set. The court recognised that while the claimants knew of the term “LIBOR,” they did not possess an active understanding of the LIBOR rate. Therefore, this case ruled that for the claimant to succeed in a case of misrepresentation, they have to be consciously aware of the nature of the representation. This means that reliance cannot be assumed and must be established through active awareness of the representation.[459]

2.4.3 The Effectiveness of Section 90A

Section 90A establishes a self-contained legal pathway for investors to claim for compensation based on defective secondary market disclosures. With comparatively lower burden of proof, it effectively displaced the need to rely on the common law tort of deceit.

However, significant uncertainty seems to remain regarding the proper interpretation when applies Section 90A in practice. Compared to the stricter common law requirements, the adoption of an objective standard of reasonable reliance may be a step in the right direction, as was previously discussed in *the ACL Netherlands BV.* In this case, the ruling shows that

[459] It should be noted that *Leeds* (note 457) is not a FSMA 2000 s 90A case, but it is a key case showing how to prove reliance.

whether someone relied on something always depends heavily on the specific facts of each case.

Although the *Serco* ruling showed a readiness to take indirect forms of reliance into account, it is still unclear if this strategy will be adopted more strictly and widely. Notably, the court rejected the *Allianz'*s interpretation of indirect reliance. It implies that, in practice, Section 90A may still present evidentiary and legal challenges akin to those in the common law to some extent.

All in all, the uncertainty in interpretation of reliance draw attention to more general worries regarding Section 90A's usability and efficacy as an investor protection tool.

2.5 Summary

This Section has shown how claimants proceed with civil actions using Section 90 and 90A and suggests that a civil action brought under Section 90 is not challenging, but the requirements of Section 90A is much more challenging for claimants.

With regard to Section 90, investors benefit from the statutory remedy compared to under common law. However, the scope of Section 90 remains uncertain for after-market purchasers, as well as the application of the "negligence" standard in defence. The main advantage in Section 90 is that the claimant is not obligated to demonstrate reliance on the misstatement during the acquisition of the securities. Furthermore, it seems that a major obstacle to collective action has been removed. Nevertheless, where there may be ambiguity in Section 90, common law, as the golden legacy of Section 90, may still be of cross-fertilising relevance.

Firstly, even while Section 90 does not specifically call for claimants to demonstrate a duty of care, this does not rule out the existence of it.[460] The statutory framework's silence on the it does not eliminate the conceptual relevance of duty of care as an inherent element of liability.

Second, in after-market contexts, disregarding the duty of care under Section 90 risks imposing disproportionate liability on defendants. To mitigate this, defendants may invoke causation defences akin to the "tracing" requirement in U.S. securities law, which links losses directly to specific misstatements (Eg *Possfund*). This underscores the necessity of implicitly acknowledging duty of care to ensure an equitable scope of liability.

Thirdly, though Section 90 traces its origins to the Directors' Liability Act 1890 and the Companies Act 1929, neither statute explicitly imposed liability on issuers. Historically, issuer liability was confined to common law remedies like rescission, leaving statutory accountability for misstatements

[460] Eg Martin Bengtzen, 'EU and UK Investment Disclosure Liability: At Cross Purposes?' (2016) 11(3) Capital Markets Law Journal 429.

underdeveloped until modern reforms.[461] Therefore, interpreting Section 90 in a way that excludes any common law consideration may still lack rigor. At least for issuers, it might be worth considering that Section 90 has some relevance to contract law.

Regarding Section 90A, investors may face more obstacles in carrying out litigation.

Firstly, compared to an objective standard, a subjective standard of dishonesty may be difficult to prove for the claimant. For instance, the defendant may have a unique understanding of the evidence, which could differ significantly from what a reasonable person might understand in the circumstances. Consequently, without enough circumstantial evidence, it may be incredibly difficult to prove that the defendant does not have an honest belief. In other words, as the defendant is better placed to present the details of the case, they are more likely to demonstrate that they held an honest belief that what they stated was true.[462]

Second, Section 90A likely requires proof of direct reliance by the claimants. Claimants must demonstrate both (1) awareness of the misstatement during the transaction and (2) that the misstatement materially

[461] Ernest L Folk III (1969), note 149, 10.

[462] Even if the defendant holds an honest belief, once the ground of belief is unreasonable, such honestness is not worth being protected in the U.S. class action. *Ernst & Ernst v Hochfelder* (1976), note 168.

influenced their investment decision. Here, its reliance requirements mirror those of deceit. The stringency of Section 90A reflects a balance in public interest objectives that investor protection should not promote exposing defendants to the broad liability risks or, vexatious, frivolous litigation.

The asymmetrical rigor between Sections 90 and 90A fails to conclusively establish investor-friendly litigation support under the U.K.'s mandatory disclosure regime. While Section 90 embodies a relatively generous stance—offering an investor-friendly cause of action—Section 90A imposes stringent thresholds rooted in subjective dishonesty and transaction-based causation (reliance). This contrast reflects a deliberate policy choice to calibrate competing interests. The resulting dual structure illustrates the U.K.'s distinct regulatory philosophy: in contrast to the litigation-centric model of the U.S.—particularly under Rule 10b-5 and the fraud-on-the-market theory, which position private enforcement as a central enforcement mechanism—the U.K. adopts a more restrained approach that aims to balance individual redress with collective market stability.

This asymmetry stems from a conscious institutional calculus that resists viewing securities litigation as an absolute remedy for investors. As highlighted in the *Davies Report*, regulatory priorities in the U.K. favour preserving London's attractiveness to issuers over maximising litigation outcomes for claimants.[463] Section 90A exemplifies this pro-market orientation: by incorporating proof elements analogous to those in the common law tort of deceit. Parliament has erected substantive evidentiary hurdles designed to insulate secondary markets from disruptive litigation. These barriers serve to prevent the phenomenon of "litigation overhang"—the risk that excessive lawsuits might suppress market valuations and deter future listings.

In sum, the bifurcated liability regime reflects a model of institutional balancing: protecting primary market investors in Section 90, while shielding secondary market dynamics through the restrictive architecture of Section 90A. This approach is consistent with Britain's tradition of principled pragmatism—eschewing ideological uniformity in favour of hybrid solutions that reconcile investor protection with issuers' regulatory arbitrage power. This institutional complementarity philosophy will be explored in greater depth in Chapter V Section 2.

3. Procedural Factors that Impede Private Securities Enforcement

Section 2 argued that the U.K.'s support for private investor litigation in furthering investor protection objectives is a nuanced one. This is reinforced

[463] Paul Davies, *Davies Review of Issuer Liability* (HM Treasury 2007) 3.

by the flaws in procedural aspects of securities litigation.

In private enforcement of securities, the number of victims in the market may be large, but the individuals are often extremely dispersed.[464] Firstly, the individual private litigant lacks litigation resources, information, and financial capacity; and must face a more powerful defendant. Therefore, the litigant has fewer incentives to initiate private litigation since it is more difficult to confront the defendant at trial. Second, the amount of compensation for an individual litigant versus the amount of compensation for all victims may be of the order of one in ten thousand. On top of that, the litigant needs to consider the time, attorneys' fees, and other costs. With all this in mind, it is often reasonable for the litigant to choose to abandon the claim.[465] If a large number of litigants follow suit, then the function of private enforcement will be meaningless.[466] Therefore, in the field of private enforcement, procedural features encourage collective actions that mitigate the disadvantages that an individual faces in traditional litigation. In the U.K., the main collective actions available are Group Litigation Order (GLO), Representative Action (RA), and Collective Proceedings Order (CPO).

[464] David Freeman Engstrom, 'Agencies as Litigation Gatekeepers' (2013) 123 Yale Law Journal 616, 694.

[465] Martin Gelter, 'Risk-shifting Through Issuer Liability and Corporate Monitoring' (2013) 14 European Business Organization Law Review 497, 528.

[466] Jürgen G Backhaus, Alberto Cassone and Giovanni B Ramello, 'The Law and Economics of Class Action Litigation: Setting the Research Agenda' in Jürgen G Backhaus, Alberto Cassone and Giovanni B Ramello (eds), *The Law and Economics of Class Actions in Europe: Lessons from America* (Edward Elgar 2012) 3.

	Group Litigation Order	Representative Action	Collective Proceedings Order
Types of Collective Action	Opt-in	Opt-out	Opt-in or Opt-out
Standard of Certification	Common or Related Issues of Fact or Law	The Same Interest	The Same, Similar or Related Issues of Fact or Law
Securities Private Enforcement	Yes	Yes	No

Figure 2: Overview of Group Litigation Options and Key Elements

3.1 The Current Collective Actions

3.1.1 Group Litigation Orders

Under Civil Procedure Rules (CPR), a collective action could be established by means of a Group Litigation Order (GLO).[467] For cases where most claimants have "common or related issues of fact or law," GLO provides an opt-in mechanism for claimants.[468] All potential GLO claimants must go through the registration process before they can officially become a member of the GLO collective action. Compared with the Representative Action mentioned below, a GLO is much simpler in its procedure. In practice, it is easier for GLO litigation to meet the procedural requirements for trial.[469] However, from the perspective of the number of cases, there are only about five GLO cases per year (and these include cases on financial services,

[467] Civil Procedure Rules (CPR), s III, pt 19.

[468] In the process of applying the GLO, it is not the same as the opt-out Class Action in the United States.

[469] As of 10 November 2022, there have been 111 group litigation orders since the GLO was introduced in 2000. The latest GLO is Port Talbot Steelworks Group Litigation. <https://www.gov.uk/government/publications/group-litigation-orders/list-of-group-litigation-orders.> accessed 15 April 2024.

environmental claims, data leakage, etc). For securities litigation, GLO is not the main tool for collective action.[470]

The members of a GLO need only be concerned by "common or related issues of fact or law."[471] That is to say, the exact claim or interest may differ amongst claimants participating in the lawsuit. The defendant may be liable to each claimant separately. Furthermore, to proceed with a GLO, one must show that the GLO will save material costs. If this is not the case, the GLO will not be granted by the court.[472] The determination of what qualifies as "common or related issues of fact or law" is the discretion of the judge.[473] The interpretation of "common or related" for GLOs suggests that different claims can have differences; the degree of acceptable difference is the object of case law.[474] In *Lungowe*,[475] the High Court made significant progress in defining "common or related." In this case, there were 2,000 individual claimants, and different law firms represented different groups of claimants. Although different communities were involved, and some of the claimants raised specific issues, the court held that all the claims were "common or

[470] Ibid.

[471] CPR 19.21. Potential members do not need to meet the requirements of "the same interest" in the Representative Action. See Chapter III Section 3.1.2.

[472] *R v The Number 8 Area Committee of the Legal Aid Board* [1994] PIQR 476, 480 (Popplewell J).

[473] CPR 19.22. The issue of GLO.

[474] On the contrary, in the Representative Action, the anchor point is "the same interest," that is, the standard of the test in the Representative Action is expanded around "the same" as a benchmark.

[475] *Lungowe v Vedanta Resources Plc and other* [2016] EWHC 975 (TCC), [2016] BLR 461.

related" based on the same mine and the same type of damage. Therefore, the presence of different attorneys representing claimants, of personalised litigation strategies, and of personnel from different communities cannot prevent a GLO from proceeding.[476]

Finally, after proving that their claim is "common or related," claimants need to register in the group register. Registration can be seen as the claimants authorising the GLO to exercise their rights on their behalf. Nevertheless, as the ruling presumes that the number of individuals involved can be ascertained, the registration process is subject to a deadline.[477] The characteristic of GLOs is that they adopt the opt-in mechanism, and each individual potential GLO claimant needs to meet the requirements of group registration.[478] Registration may require the representative to publish the GLO, so allowing more claimants a chance to enrol. The cost of advertising has been controversial. In *Motto*,[479] the court held that advertising costs could not be recovered since these expenses associated with obtaining business – such as advertising to the public, making presentations to potential clients, or discussing a possible instruction with a potential client – should not be

[476] Ibid. When compared with *Lloyd v Google LLC* [2021] UKSC 50, [2022] AC 1217 (a representative action case), these two cases show the difference between the standard of GLO and the test for representative action.

[477] Susan MC Gibbons, 'Group Litigation, Class Actions, and Collective Redress: An Anniversary Reappraisal of Lord Woolf's Three Objectives' in Déirdre Dwyer (ed), *The Civil Procedure Rules Ten Years On* (OUP 2009) 129.

[478] CPR 19.21.

[479] *Motto v Trafigura* [2011] EWCA Civ 1150, [2012] 2 All ER 181.

charged to the client. These expenses should be considered as part of a solicitor's general overhead or expenses, which can be taken into consideration when determining appropriate fees, such as hourly rates.[480] Accordingly, the advertising may be costly for the representative, potentially jeopardising the scale of the group.[481]

3.1.2 Representative Action

There is an opt-out mechanism in the U.K. class action. In cases where multiple claimants sue the same defendant, all claimants face similar issues of fact as well as law. In this kind of case, a claimant can proceed with representative proceedings according to the Civil Procedure Rules. Unlike the GLO, Representative Actions are not opt-in, but opt-out. In theory, it is difficult for a claimant to bring this type of collective action with a large scale because, although there is no restriction on it, a representative claimant can only represent parties who have "the same interest" when filing a lawsuit.[482] In a representative legal proceeding, any judgment or settlement issued by the court is legally enforceable against all individuals or entities the representative party seeks to represent.[483] The procedure does not require the represented members to authorise representation, nor does it require the

[480] Ibid [110].

[481] Ibid.

[482] CPR 19.8(1).

[483] *Howells v Dominion Insurance Co Ltd* [2005] EWHC 552 (QB).

court's permission in advance. Therefore, this procedure must consider whether the represented members and the representative have similar litigation claims. That is to say, interpreting what is meant by "the same interest" will be crucially significant.[484]

For the sake of represented members, when British courts have interpreted the procedural elements of "the same interest," the applicable conditions for representative action are harsh.[485] But the trend more recently has been towards a gradual relaxing of these conditions in the case law. In *Emerald*, the court interpreted "the same interest" (CPR 19.8) to be equivalent to the idea that "the claimants and the class they seek to represent must all have 'a common interest and a common grievance' and 'the relief sought [must] in its nature [be] beneficial to all' of them."[486] In the most recent *Lloyd v. Google* ruling,[487] the criteria for establishing "the same interest" were made more lenient. In this case, although the information accessed by 4 million users on their phones was not identical, it was considered to be of "the same interest." The court ruled that the determination of "the same interest" should

[484] As discussed in *Emerald Supplies Ltd v British Airways plc* [2009] EWHC 741 (Ch), [2009] 3 WLR 1200.

[485] The courts originally interpreted the standard "same interest" as suggesting that all claimants should have identical issues of fact and law, which would mean that all parties would need to have the same contract, seek the same relief and use the same defence in the proceedings. *Markt & Co Ltd v Knight Steamship* [1910] 2 KB 1021 (CA).

[486] *Emerald Supplies*, note 484, 33. The representative action was unsuccessful since purported members were so wide that it was impossible to identify them.

[487] *Lloyd v Google LLC*, note 476.

not depend on individual, personalised facts. Instead, given the common claim of "loss of control" of their browser-generated information, they should be considered to have "the same interest."[488]

3.1.3 Joint Case Management

In the two previous collective actions, namely GLO and RA, the claimant must choose which type of action is best suited in order to bring a claim with other claimants. However, in addition to these two collective actions, the courts in the U.K. can invoke Joint Case Management, a judicial right to combine multiple cases. This right allows courts to combine separate cases at their discretion and to come to a decision with joint effect.[489]

Joint case management proceedings give courts considerable flexibility. It is to be considered in cases where it would greatly reduce judicial costs when dealing with multiple claims. For securities litigation, in particular, the form of joint case management is attractive. The disadvantage of such a model, however, is that the initiative for the management is not in the hands of the claimants. Instead, it is the court's decision.[490] Furthermore, the process is subject to stringent rules. For example, the court in *Reichhold* examined

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[488] Ibid [75]. Although the Supreme Court was willing to relax the standard of "the same interests," it dismissed Lloyd's claim because the "loss of control" was not considered sufficient to warrant the broader interpretation (Ibid).

[489] CPR 19.24. and (h). Eg *Office of Fair Trading v Abbey National Plc & Others* [2008] EWHC 875 (Comm), [2008] 2 All ER (Comm) 625.

[490] Ibid.

the conditions for implementing joint case management and determined that it should only be used in "rare and compelling circumstances."[491]

3.2 Proposal for Reform

For private securities enforcement, GLO, RA, and Joint Case Management have not become effective avenues for redress since there has been little securities litigation of these types.[492] Is there a need for reform to change the thresholds required for GLO or RA? Or should legislation create a new collective action for claimants? It seems that the U.K. is choosing the latter and preparing for it.[493]

In October 2015, the available types of collective action in the U.K. underwent a fundamental change. Schedule 8 of the Consumer Rights Act 2015 (CRA 2015) made significant adjustments to the Competition Law Class Action (Competition Act 1998, s 47A), so providing a new litigation class.

According to Schedule 8 of the CRA 2015, the Competition Appeal

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[491] *Reichhold Norway ASA v Goldman Sachs International* [1999] EWCA Civ 1703, [2000] 2 All ER 679. In order to proceed with joint case management, the court must comply with Regulation (EU) No 1215/2012 of the European Parliament and of the Council of 12 December 2012 on jurisdiction and the recognition and enforcement of judgments in civil and commercial matters [2012] OJ L351/1 (Brussels recast), arts 4 and 34.

[492] Eilís Ferran, *Principles of Corporate Finance Law* (OUP 2008) 460.

[493] Civil Justice Council, *Improving Access to Justice through Collective Actions: Developing a More Efficient and Effective Procedure for Collective Actions* (Final report, Civil Justice Council, July 2008).

Tribunal Rules 2015 (CAT Rules 2015)[494] and the CAT's Guide to Proceedings 2015,[495] a Collective Proceedings Order (CPO) is introduced by the CRA 2015. The new CPO reform's implementation broadens the range of allegations that the CAT can consider.[496] With the CRA 2015 and the CAT Rules 2015, a group of claimants, or an organisation representing them, can ask the CAT to approve a class action lawsuit through a CPO.[497]

In the U.K., whether we are concerned with a brand-new class action or a GLO or RA, the key to bringing a collective lawsuit lies in obtaining certification to proceed.[498] The CAT must attest in the CPO application that the prospective claimants have "the same, similar or related issues of fact or law." This standard is essentially different from the standard in GLO and RA.[499] The court should evaluate if there is some other legal option that could be taken instead of granting a CPO. It may be determined that a GLO or RA would be more suitable than the CPO in these cases.[500] Unless they choose to

[494] Competition Appeal Tribunal Rules 2015, SI 2015/1648 (CAT Rules 2015).

[495] Competition Appeal Tribunal, *Guide to Proceedings* (Competition Appeal Tribunal, 2015) 137.

[496] The CAT was only allowed to consider claims that were based on a prior decision of a court or relevant authority that a breach of competition law had taken place. A collective proceedings order, however, could be brought forward as an independent case, without any prior decision about a breach of competition law having been made.

[497] Andrew Higgins, 'Driving with the handbrake on: Competition class actions under the Consumer Rights Act 2015' (2016) 79 MLR 442-467. Competition Act 1998 (CA 1998), s 47B and CAT Rules 2015, r 79 detail the requirements that must be met for the CAT to certify a CPO.

[498] Rachael Mulheron, 'Reform of collective redress in England and Wales' (2008) Civil Justice Council 9-36.

[499] CA 1998, s 47B (6).

[500] CAT Rules 2015, r 79(2).

actively opt out of the proceedings, any members of the class are bound by the decision or settlement once the court has approved the class in an opt-out case. All class members are legally bound by the CPO ruling or settlement.[501]

The CPO has only just been discussed in the case law as a legal resort for standalone disputes.[502] In the case of *Merricks*,[503] the court deemed that the certification should be based on the capacity to efficiently combine the claims rather than on the probability of succeeding at trial.[504] The court chose to return the case to the CAT, believing that the prior limitations imposed on CPOs had been too strict.[505] After this crucial adjustment of CPO certification, in August 2021, the CAT officially certified the Merricks CPO as the first standalone CPO case.

Nevertheless, private enforcement does not generally operate on an opt-out class action. In response to the appeals of academics and the needs of the judicial practice, the government still considers that it is risky to generalise the CPO model and maintains that the application of CPO should be on a

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[501] It is worth noting that the settlement procedure of CPO can be completed before the CAT certifies a CPO because, at this stage, it may be considered as alternative dispute resolution (ADR).

[502] The first standalone collective claim was considered in *Mastercard Incorporated & Others v Merricks* [2020] UKSC 51, [2021] 3 All ER 285.

[503] Ibid.

[504] Ibid [158].

[505] *Mastercard v Merricks* (note 502) overruled the requirements of certification of CPO in *Justin Le Patourel v BT Group Plc* [2021] CAT 32. For the substantive merits, see Robert G Bone and David S Evans, 'Class Certification and the Substantive Merits' (2002) 51(4) Duke Law Journal 1251.

sector-by-sector basis.[506] So far, the CPO-type action has not been extended to securities private enforcement.[507]

Even if a CPO can be used in securities private enforcement, this collective procedure is not necessarily easier for claimants. Initially, a CPO may not be an opt-out collective action, as the judge may determine that it shall be conducted as an opt-in CPO.[508] Second, even in *Merricks*, the stringent threshold of substantive merit was overturned by the Court. The question of whether a CPO will demand substantial evidence in private enforcement of securities is becoming increasingly significant, since each case is treated differently depending on sector-by-sector basis. Thirdly, under Section 90A, the court does not want to apply the fraud-on-the-market theory, which means the harsh element of "causation" in Section 90A would prevent the claimant from meeting the substantive merit required for a CPO. And, although, in theory, a claimant can force the issuer to disclose relevant company information through "disclosure,"[509] since the information has commercial value, U.K. courts would be reluctant to approve such disclosures

[506] Herbert Smith Freehills, 'Government rejects Generic Collective Action in Favour of Sector-by-sector Approach' (Litigation Notes, 22 July 2009) <https://hsfnotes.com/litigation/2009/07/22/government-rejects-generic-collective-action-favour-sector-sector-approach/> accessed 30 December 2022.

[507] Financial Services HC Bill (2009–10) [6], s 17 ('Collective Proceedings'). A suggestion was made to allow collective proceedings to be brought forward in relation to claims concerning financial services. But see Civil Justice Committee, *Draft Court Rules for Collective Proceedings* (Civil Justice Committee, 2 February 2010).

[508] *Road Haulage Association Limited v Man SE and Othe*rs [2022] CAT 25.

[509] Stuart Sime, *A Practical Approach to Civil Procedure* (OUP 2022) ch 31.

because they might be considered a kind of informed speculation.[510] Claimants could easily fail to detect the real state of mind of the issuer due to the subjective standard. Further, issuers acting with an "honest belief" may escape liability under Section 90A. Finally, the CPO includes retention of the "Loser Pays" rule (see "Loser Pays" rule discussed in Section 3.3). Beyond this, the CPO is not going to change the use of contingency fee restrictions (see "Contingency Agreements" in Section 3.3). This lack of economic incentive is likely to hinder claimants and law firms from proceeding with a CPO case.

3.3 Procedural Barriers to Legal Redress

Furthermore, a claimant's incentive will take into account the cost of lawsuit and the likelihood of losing the case.[511] The U.S. class action litigation cost-bearing rule states that the parties must bear the costs themselves.[512] By contrast, if the trial is lost in the U.K., the defendant must reimburse the claimant for their reasonable legal expenses.[513] CPR 44 outlines the standard principle concerning legal costs: "the unsuccessful party

[510] *Black v Sumitomo Corporation* [2001] EWCA Civ 1819, [2002] 1 WLR 1562. See also *Moresfield Ltd and others v Banners* [2003] EWHC 1602 (Ch).

[511] John C Coffee, *Entrepreneurial Litigation: Its Rise, Fall, and Future* (HUP 2015) ch 2.

[512] Ibid. But see William K Sjostrom, 'The Intersection of Fee-Shifting Bylaws and Securities Fraud Litigation' (2015) 93 Washington University Law Review 379, 381.

[513] John C Coffee, '"Loser Pays": The Latest Instalment in the Battle-Scarred, Cliff-Hanging Survival of the Rule 10b-5 Class Action' (2015) 68 SMU Law Review 689, 695.

will be ordered to pay the costs of the successful party."[514] Therefore, in multi-party litigation, participants must be aware of their potential liability to bear the issuer's legal expenses.

If the claimant proceeds by bringing a Representative Action, the presenting party, the representative, must assume all the risk and costs alone. The court does not recognise represented parties as formal parties to the trial, so the representing party is the only one to suffer the "Loser Pays" rule. In an unsuccessful trial, the representing party is the only loser.[515] A GLO for securities private enforcement follows the same cost rules as for RAs, except that individuals in a GLO are recognised as parties. Costs are therefore split between the individual claimants. Although the reasonable costs will be split, they may include costs relating to GLO certification, the cost of lead solicitors, and other administrative fees. Accordingly, the "Loser Pays" rule makes the legal cost unpredictable, which may deter claimants from deciding to join the GLO.[516]

Beyond the "Loser Pays" rule, the restrictions on Contingent Fee Agreements in the U.K. are not conducive to collective action either. The U.S.

[514] CPR 44.2(2)(a).

[515] Masayuki Tamaruya, 'Securities Class Actions: Anglo-American Comparison and Cross-Border Implications' (2012) 23 EBLR 91, 99.

[516] Eg Mark Mildred, 'Group Actions' in Geraint Howells (ed) *The Law of Product Liability* (2nd edn, Butterworths 2007) ch 7; John Sorabji, 'The Hidden Class Action in English Civil Procedure' (2009) 28 CJQ 498-514.

Class Action system allows attorneys to make agreements with claimants, creating an entrepreneurial feature. Through such agreements, attorneys may accept to take a certain percentage from recovery if the lawsuit is successful or settled and to take nothing in the event the litigation is unsuccessful.[517] However, in the U.K., the legislation only permits lawyers to sign a conditional fee agreement, which increases the legal fee rather than providing a share of the recovery.[518] As we can see in practice, given that promoting private securities litigation is not economically promising, the trend for law firms to speculate on securities collective action does not exist in the U.K. as it does in the U.S.[519]

In the U.K., legal practice is looking to create an alternative to avoid the obstacles of the conditional fee agreement.[520] Third-party funding is one of these options (Professional Third-Party Funder). A third party may provide a litigant with financial assistance to cover their legal costs, and in the event of a positive resolution, the third party may be entitled to a share of any settlement or judgement.[521] In *Arkin*,[522] the court concluded that "a professional funder, who finances part of a claimant's costs of litigation,

[517] See Chapter II Section 3.3.

[518] Conditional Fee Arrangements Order, SI 2000/823.

[519] Paul Davies (2007), note 463, 3.

[520] Eg John Sorabji and Robert Musgrove, 'Litigation, Cost, Funding, and the Future' in Déirdre Dwyer (ed) (2009), note 477, 244-246.

[521] *Arkin v Borchard Lines Ltd* [2005] EWCA Civ 655, [2005] 1 WLR 3055.

[522] Ibid.

should be potentially liable for the costs of the opposing party to the extent of the funding provided."[523] However, later case law indicated that a specialised third-party funder needs to be considered a trial participant.[524] It means that a professional third-party funder must assume the risk and uncertainty that follows from the general costs rule in the CPR.[525] We can see this rule in action in the Lloyds/HBOS litigation.[526] Although the High Court rejected Lloyds' claim filed in the acquisition of HBOS, the court permitted the judgment on costs issues on appeal. The court ruled that the third-party funder was joint and several (rather than secondary) liable for reasonable costs, as opposed to the funder's claim that they should only be liable for the amount that the claimants could not satisfy if they lost.[527]

3.4 Summary

The U.K.'s collective litigation framework shows substantial barriers to private securities enforcement, creating an inhospitable landscape for claimants seeking redress.

Existing procedural mechanisms—GLO, RA, and Joint Case Management—are underutilised in practice due to procedural constraints.

[523] Ibid [41].

[524] See the Lloyds/HBOS litigation: *Sharp & Ors v Blank & Ors* [2020] EWHC 1870 (Ch), [2020] Costs LR 835.

[525] CPR 44.2(2)(a).

[526] *Sharp v Blank,* note 524.

[527] Ibid [34].

Specifically, GLO suffer from low uptake (averaging around five cases per year) and burdensome opt-in requirements. RA, although structured as opt-out actions, are narrowly accepted by courts, particularly regarding the “same interest” requirement. Joint Case Management offers flexibility but is entirely court-driven, affording limited control to claimants.

Although, the introduction of CPO under the 2015 competition law reforms represented a step forward in collective redress, securities litigation was explicitly excluded from their scope. Further, even if CPO extended to securities litigation, CPO would face significant practical hurdles. For example, other procedural obstacles like the “Loser Pays” rules and restrictions on contingency fees will also affect the proceeding of CPO.

Taken together, these structural deficiencies—rigid certification thresholds (limited scale) and weak incentives for legal practitioners—discourage both harmed investors and law firms from pursuing collective securities actions. As a result, the U.K. framework falls short in providing effective remedies for dispersed investor harm, undermining the enforcement of investor protection through private litigation.

4. The Complementarities Consideration: The Role of Securities Public Enforcement

The above discussion shows that unlike in the U.S., securities private enforcement in the U.K. is not strongly encouraged or supported, whether because of the structure of substantive law or because of the collective action mechanisms for access to justice. Does this suggest a mismatch between the legal rules on the books and the prestige of the U.K. capital market? Should reform be made for improving securities litigation, such as reforming Section 90A and CPO?

However, the reform of securities private enforcement may also depend on how other parts of investors protection institution work to protect investors. In this section, it will explore how public enforcement works, i.e. carried out by the Financial Conduct Authority (FCA), taking a perspective of institutional complementarity.

4.1 FCA Securities Enforcement Actions

4.1.1 The Goal of Establishment of FCA: Proactive Investor Protection

The FCA is an important regulatory body in the U.K.'s financial sector, established in 2013 as part of a major overhaul of the country's regulatory framework. It was developed in response to lessons learnt during the global financial crisis of 2007–2008, which revealed flaws in the prior system that was supervised by the Financial Services Authority (FSA).

The FSA, established in 2001, had consolidated regulatory responsibilities under a single authority, across banking, securities, investment and insurance businesses,[528] replacing earlier fragmented bodies like the Securities and Investments Board (SIB).[529] However, the financial crisis revealed critical flaws in the FSA's approach, as a single regulator with too many objectives ultimately failed to address systemic risks and protect consumers effectively.[530]

In response to the crisis, the U.K. government commissioned the *Turner Review* in 2009, authored by Lord Adair Turner, then-chair of the FSA. This report analysed the root causes of the crisis, in both substantive regulation and regulatory architecture, and advocated for sweeping reforms.[531] It called for stricter oversight, higher capital requirements, and a focus on systemic stability. These suggestions served as the foundation for the Financial Services Act 2012, which disbanded the FSA and established a new "twin-peaks" regulatory structure.[532] In "twin-peaks" structure, the FCA was tasked with monitoring competition, market conduct, and consumer protection under

[528] Clive Briault, 'Revisiting the Rationale for A Single National Financial Services Regulator' (Financial Services Authority Occasional Paper 16, 2002).

[529] David Severn, '50 Years of Regulation' *FT Adviser* (23 March 2012) <https://www.ftadviser.com/2012/03/23/regulation/regulators/years-of-regulation-yq3MepSdumFQf1Q2OIMrwM/article.html> accessed 24 June 2025.

[530] Michael W Taylor, 'Regulatory Reform after the Financial Crisis: Twin Peaks Revisited' in Robin Hui Huang and Dirk Schoenmaker (eds), *Institutional Structure of Financial Regulation* (Routledge 2014) 9-28.

[531] FSA, *The Turner Review: A Regulator Response to the Global Banking Crisis*, (2009).

[532] Eilis Ferran, 'The Break-up of the Financial Services Authority in the UK' in in Robin Hui Huang and Dirk Schoenmaker (eds) (2014), note 530, 109-136.

this arrangement, while the other one was Prudential Regulation Authority (PRA), a branch of the Bank of England, which is responsible for ensuring the financial stability of major institutions such as banks and insurers.[533]

Protecting consumers, maintaining fair markets, and fostering competition are at the heart of the FCA's mission. In addition, it is the London Stock Exchange's Listing Authority and regulates securities markets. In contrast to the FSA, the FCA takes a relatively proactive approach, taking action early to stop harm—for example, by outlawing risky financial products or fining companies for misrepresenting their products. Accountability and transparency are given first place over the FSA's previously criticised passivity in this approach.[534] In contrast, the PRA focusses on prudential regulation in the meantime to ensure that businesses control risks, maintain adequate capital, and endure economic shocks. This division of responsibilities aims to balance consumer protection with systemic stability.[535] Since its inception, the FCA has become known for its assertive enforcement, tackling issues like market manipulation, financial crime, and

[533] Ibid.

[534] Andromachi Georgosouli, 'The FCA-PRA Coordination Scheme and the Challenge of Policy Coherence' (2013) 8(1) Capital Markets Law Journal 62, 63-65.

[535] Ibid.

unfair consumer practices. It emphasises transparency, requiring firms to disclose product risks and costs clearly.[536]

The development of the FCA demonstrates the U.K.'s dedication to flexible, strong regulation. The FCA can concentrate on building trust in financial markets and making sure they run effectively and fairly by keeping conduct and prudential oversight distinct. The FCA's emphasis on consumer-centric policies and proactive intervention emphasises its function as a promoter of market integrity in addition to its role as a watchdog.

4.1.2 FCA Enforcement Actions: Administrative, Civil, Criminal and Dual Track

The FCA's securities law enforcement is grounded in two primary functions: deterrence and compensation.[537]

By imposing deterrent fines and sanctions, the FCA seeks to prevent misconduct and signal the potential consequences of breaching regulatory requirements. In theory, a robust deterrent regime can complement

[536] Joseph J Norton, 'Global Financial Sector Reform: The Single Financial Regulator Model Based on the United Kingdom FSA Experience—A Critical Reevaluation' (2005) 39 International Lawyer 15, 27.

[537] John C Coffee Jr (2006), note 290, 1534-1586.

compensation enforcement, making it less necessary for investors to seek redress independently.[538]

One of the FCA's most powerful tools in deterring securities misrepresentation is its administrative authority. Here, the FCA is not bound by limits on the fines it can impose,[539] which provides a substantial deterrent against market misconduct. Additionally, the FCA can leverage criminal charges in cases of serious violations, which further strengthens its deterrent role. These powers give the FCA the potential ability to impose penalties that are large enough to discourage fraudulent behaviour and encourage compliance with securities laws.

Firstly, administrative enforcement is the most common and widely used form of action by the FCA. It refers to the administrative sanctions that the FCA can impose on firms, individuals, or listed issuers who breach the regulations set out in the FSMA 2000 or the FCA's own rules. When the FCA determines that a breach has occurred, it will issue a "Decision/Final Notice" to the relevant firm or individual, outlining the alleged breach and proposing a penalty or other action. In practice, these penalties may include fines,

[538] Eg Daniel Reed, 'Compensation and Deterrence in Antitrust: How Realistic Is the Achievement of an Optimal Level of Deterrence under a Private Enforcement Regime?' (2020) 23 Mountbatten Journal of Legal Studies 6-31.

[539] D Jasinski, 'The FCA: Protecting Consumers of the Consumer Credit Market in the Wake of the Financial Crisis' in Nicholas Ryder, Umut Turksen and Jon Tucker (eds), *The Financial Crisis and White Collar Crime: Legislative and Policy Responses – A Critical Assessment* (Routledge 2019) 129-177.

restrictions on business activities, or bans from holding certain positions within the industry. Recipients of these notices are entitled to refer the matter to the Upper Tribunal, an independent judicial body that will re-examine the facts and law and determine the final outcome. The FCA also uses “Warning Notices” prior to issuing decision notices, providing an opportunity for the subject of the investigation to make representations. If the enforcement action is upheld after review, the FCA can proceed with the penalty, which is typically made public as part of the FCA’s commitment to transparency.[540]

Second, the FCA has the authority to take legal action against misconduct, such as fraud, insider trading, and other market integrity violations. The FCA shares responsibility for investigating and prosecuting criminal market misconduct with other agencies, such as the Serious Fraud Office (SFO), the Crown Prosecution Service (CPS), and the Secretary of State for Business, Energy and Industrial Strategy. These agencies have agreed on a set of guidelines for deciding which agency should take the lead in any given case.[541]

It should be noted that “Dual Law” enforcement refers to situations where the FCA’s administrative/civil powers overlap with criminal law enforcement.

[540] Leo Davidson, ‘Enforcement procedure’ in Thomas Ogg and Richard Leiper QC (eds), *Conduct and Pay in the Financial Services Industry* (Informa Law from Routledge 2017) 215-239.

[541] FCA, *FCA Handbook*, 12 Prosecution of Criminal Offences.

In such cases, the FCA may pursue administrative/civil and criminal actions in parallel, addressing misconduct from both an administrative/civil and a criminal perspective. In dual law enforcement cases, the FCA has the authority to pursue an administrative/civil proceeding, while criminal charges would be pursued through the court system.[542]

Tasked with ensuring that markets function well and that consumers are protected, other than administrative, criminal, and dual enforcement actions, the FCA can employ a standalone civil action to enforce firms and individuals accountable for violations of financial regulations. Here, civil action refers to the FCA's use of civil litigation—most notably under Section 383 of the FSMA 2000—to secure restitution orders, rather than to impose regulatory or criminal sanctions. Under the FSMA 2000, the FCA may pursue civil action against firms or individuals for market abuse, fraud, misleading financial promotions, and other breaches that compromise investors or impair market integrity.[543]

4.2 Compensation for Investors' Loss from FCA Securities Enforcement: FCA Restitution Order

4.2.1 Legal Sources of Restitution Order

[542] Eg FCA, *Enforcement Data 2023/24*, 7.

[543] Eg Robert Falkner and Jon Gerty, 'A Summary of the Financial Services Authority's Enforcement Procedures in the United Kingdom' (2006) 7(1) Journal of Investment Compliance 69, 70-71.

The FSMA 2000 governs financial services regulation in the U.K. securities market. Among its provisions, Sections 382, 383, and 384 offer restitution following regulatory breaches. These Sections are designed to ensure that victims can be compensated for losses.[544]

The three Sections, while related, differ significantly in their scope of application, enforcement mechanisms, and the process for initiating restitution orders.

When a person or firm violates any "relevant requirement," Section 382 of the FSMA 2000 comes into play.

Firstly, regardless of whether there is market abuse involved, this clause covers a wide range of violations, such as breaking laws pertaining to disclosure, licensing, and other general legal duties. Because of this, Section 382 is broad and covers a number of regulatory violations in the financial services industry.[545] Further, depending on the type of violation, the relevant regulatory body—which could be the FCA, the PRA, or other suitable entities—usually initiates restitution enforcement under Section 382. Once the court determines that the violation has resulted in losses or negative consequences for other parties, then a proper restitution order under Section

[544] Joanna Gray, 'Regulatory Restitution under Financial Services Legislation' (2004) 12 RLR 52, 54.

[545] FCA, *FCA Handbook EG 11.1* Restitution orders under Sections 382, 383 and 384 of the Act: the FCA's general approach (FCA).

382 will be issued.[546] Lastly, the regulator (such as FCA) is in charge of distributing the restitution funds to the victims after the court has decided on the amount of restitution.[547]

Section 383 is specifically focused on market abuse.[548] This provision applies exclusively to violations that involve market abuse, which represents a narrower focus than Section 382.

Here, the FCA is the designated regulatory authority for initiating restitution orders under Section 383. Similar to Section 382, under Section 383, a restitution order may be issued if the court determines that: the violators has profited from engaging in market abuse, and the market abuse has caused financial losses or adverse effects to other participants in the market. Once a court order is issued, the FCA receives the restitution funds and distributes them to the victims. Notably, compared to the general scope under Section 382, the focus here is on compensating those who have suffered due to the manipulation or distortion of the market. [549] Thus, Section 383 provides defences for such a specific violation. The defendant may argue that: They could assert a defence by demonstrating either (1) a reasonable ground for believing their actions did not violate market abuse regulations, or (2) the

[546] Eg *FCA v Exall* [2023] EWHC 1130 (Ch).

[547] Ibid.

[548] FCA, *FCA Enforcement Guide*.

[549] Ibid.

implementation of prudent measures alongside rigorous due diligence to prevent conduct falling within the scope of market abuse. [550]

Section 384 significantly differs from Sections 382 and 383 in that it allows regulatory bodies, such as the FCA or PRA, to directly impose restitution orders without the need for court involvement.

Firstly, this provision can be applied in both cases of comparatively general regulatory breaches (different to Section 382 since regulators here are limited to FCA or PRA) and market abuse (similar to Section 383). Section 384 grants regulators greater flexibility in enforcing restitution and compensating affected parties promptly. [551] Second, under Section 384, either the FCA or the PRA (depending on the nature of the violation) can directly require restitution from the violator, bypassing the judicial process. Here, the regulator determines both the amount of restitution and how it will be distributed to the affected parties, and either the violator's gains or the losses incurred by others as a result of the violation are taken into consideration while making the decision.[552] Lastly, similar to Section 383, Section 384 includes defence provisions (omitted, see note 550). The violator can assert

[550] FSMA 2000 s 383. It is omitted by The Financial Services and Markets Act 2000 (Market Abuse) Regulations 2016.

[551] FSMA 2000 s 384.

[552] Ibid.

that they acted in good faith or took reasonable steps to avoid violating FCA or PRA requirements.

In summary, the restitution orders outlined in Sections 382, 383, and 384 of the FSMA 2000 serve to protect the integrity of the U.K. financial markets by ensuring that victims who suffer losses due to regulatory breaches or market abuse are compensated. While Section 382 provides restitution for very general (non-market abuse) regulatory violation, Section 383 focuses specifically on market abuse, and Section 384 streamlines the process by allowing regulators to impose restitution directly, bypassing the need for judicial branch involvement.

Aspect	Section 382	Section 383	Section 384
Scope of Application	General regulatory breaches (non-market abuse)	Market abuse	Both regulatory breaches and market abuse
Regulatory Authority	FCA, PRA, or another relevant regulator	FCA	FCA or PRA (depending on the nature of the breach)
Restitution Process	Court-ordered restitution	Court-ordered restitution	Direct restitution by regulators without court involvement
Criteria for Restitution	Profits gained or losses suffered by others	Profits from market abuse or losses suffered by others	Based on profits or losses, determined by the regulator
Defences Available	Not specified	Reasonable belief or due diligence	Good faith or reasonable steps to avoid contravention
Restitution Distribution	By the regulator	By the FCA	By the regulator (FCA or PRA)

Figure 3: Table of Comparison for Restitution Orders under FSMA 2000

4.2.2 Restitution Order in Market Abuse

In scenarios where harmed investors can pursue a cause of action related to securities misrepresentation, the FCA may also recognise the issue as a market abuse case and enforce Sections 383 or 384 of the FSMA 2000. Under those Sections, the FCA can require or issue a restitution order for the harmed investors. Here, Sections 383 and 384 will be discussed as complementary resorts to securities private enforcement.

Notably, market abuse, governed by UK MAR, addresses securities misconduct such as insider dealing, unlawful disclosure of inside information, and market manipulation. Specifically, UK MAR defines these misconducts comprehensively. Insider dealing and unlawful disclosure, for example, involve trading securities using non-public material information or encouraging others to do so.[553] Market manipulation encompasses practices such as disseminating false information or engaging in misleading behaviour to influence market prices.[554] Further, issuers have a duty to reveal inside information as soon as possible, being actionable as relating to failure of disclosure as well as potentially facilitative of insider dealing. Entities must release such information to the public without undue delay, unless legally permissible exceptions apply to justify postponement.[555] Thus, conceptually, the scope of market abuse includes securities misstatement. That is, it shows

[553] *FCA Handbook*, MAR, 1.3.

[554] *FCA Handbook*, MAR, 1.6.

[555] *FCA Handbook*, DTR, 2.2 and 2.5.

a functional complementarity between FCA's restitution order and causes of actions discussed in Section 2.

The FCA's enforcement action against Tesco underscored its role (functional complementarity) in compensating investor harm through restitution order.

The roots of *Tesco* can be traced to 29 August 2014, when the company issued a disclosure predicting a trading profit between £2.4 billion and £2.5 billion for the 2014/15 financial year. This included an expected mid-year trading profit of £1.1 billion. However, on 22 September 2014, Tesco made a public correction, admitting that its profit forecast had been overstated due to improper accounting practices. Thus, the disclosure sparked a sharp downturn in Tesco's share value as investors grasped that the company's financial projections were less resilient than initially disclosed. A "market abuse" was found in Tesco's securities misconduct (misleading information), which caused the market value of its shares to soar. Investors who purchased Tesco bonds and shares suffered severe losses as a result of this deception.[556]

In response to the manipulation of the market, the FCA launched an investigation into Tesco's conduct. In 2017, the FCA concluded that the company had committed market abuse under the provisions of the FSMA

[556] <https://www.fca.org.uk/news/press-releases/tesco-pay-redress-market-abuse.> accessed 15 April 2025.

2000. Specifically, Tesco was found to have issued misleading statements about its financial position, resulting in a false market in its shares and bonds,[557] and the FCA fined Tesco £129 millions for failing to maintain adequate internal controls and for publishing misleading information.[558] In parallel, as for the consideration of compensation to harmed investors, the FCA established a compensation scheme for harmed investors under Section 384. It remains a leading example of the FCA's use of Section 384 to facilitate compensation for investor harm. For further analysis of this legal mechanism, see Section 4.2.2.2.

4.2.2.1 Section 383 Enforcement: The FCA's Reactive Role in the Civil Proceeding

Under Section 383, while the FCA has the authority to seek compensation for harmed investors, its role in the process to apply a restitution order is comparatively reactive.

One notable case is *FCA v Konstantinos Papadimitrakopoulos & Anor.* In this case, the senior executives of Globo Plc, a U.K.-based technology business, were accused of engaging in market abuse. In the lead-up to the company's dramatic collapse in November 2015, the FCA investigated the

[557] Ibid.

[558] FCA, *Final Notice, Tesco plc & Tesco Stores Limited*, 28 March [2017].

conduct of Mr. Gryparis and Papadimitrakopoulos (the former CEO) made misleading statements that inflated the value of the company's stock, and then the misconduct misled investors, causing financial damage. The FCA claims that investors bought securities at much higher prices than their true value as a result of the inflated share price, resulting in large losses when the company's true financial situation was exposed.[559]

As for enforcement, the FCA's strategy against Mr. Papadimitrakopoulos and Mr. Gryparis (the former CFO) began with the initiation of civil proceedings in the High Court under Section 383.[560] During the trial, there were some issues with the FCA's strategy. Mr. Papadimitrakopoulos's main legal contention was that the FCA had illegally obtained the evidence it used in its case. He contended that the use of some evidence in the civil proceedings was inappropriate because it had been obtained from foreign jurisdictions—specifically, Greece—through mutual legal assistance procedures.[561]

The High Court evaluated Mr. Papadimitrakopoulos's request to dismiss the FCA civil case, which argued that evidence had been unlawfully obtained. While the Court highlighted legal ambiguities surrounding evidence acquired

[559] *FCA v Konstantinos Papadimitrakopoulos & Anor.* [2022] EWHC 2792 (Ch).

[560] Ibid.

[561] Ibid.

through international mutual legal assistance mechanisms, it came to the conclusion that even though certain evidence had been improperly obtained for uses unrelated to civil proceedings, this did not justify the case being dismissed outright. The Court allowed the proceedings to proceed after concluding that the FCA's mistakes were accidental and not intentional violations of the law. [562]

This ruling emphasised that under Section 383, there is a judiciary's fundamental responsibility in assessing the scope and validity of evidence within FCA's cases addressing market misconduct. While the FCA initiated the proceeding against the defendant, the court ultimately reviewed the case by scrutinising the legality of the and the fairness of the procedure. This judicial oversight raises questions about the FCA's role as an enforcer under Section 383. That is, the FCA, despite its regulator power to initiate the proceeding, was forced to face complex judicial hurdles and seek permission from other jurisdictions to complete its case.

Next, the case took a further turn in March 2024 when the FCA decided to discontinue its civil proceedings. After almost 10 years, the FCA finally decided that it would not pursue the case further, even though it had originally

[562] Ibid.

decided to continue the proceedings following the Court's decision on the evidence.[563]

The FCA's decision to end the proceedings in this case highlights its comparatively reactive role in enforcing Section 383. Specifically, even though the FCA has a lot of authority to investigate cases of market abuse, its ability to successfully resolve these cases largely rests on the lengthy court rulings. That is, those procedural obstacles were too great to overcome for the FCA, and thus the court ultimately exerted greater influence than the FCA in shaping the trajectory and resolution of the case.[564]

To sum up, this case demonstrates the complex relationship between the FCA, the legal system, and the application of Section 383 against market abuse.

Notably, when the FCA seeks a restitution order, it seems that the FCA may first consider using its administrative powers under Section 384 because it allows the FCA independently to close a case without court participation. (See Section 4.2.2.2)

[563] <https://www.fca.org.uk/news/press-releases/fca-progresses-market-abuse-claim-against-globo-plc-chiefs.> accessed 15 April 2025.

[564] <https://www.fca.org.uk/news/statements/fca-discontinues-civil-proceedings-against-konstantinos-papadimitrakopoulos-and-dimitris-gryparis.> accessed 15 April 2025.

However, in certain situations, the FCA may prioritise opting to use Sections 382 or 383 to apply to the court for a restitution order.

One scenario where the FCA may seek a restitution order through the court is when it intends to combine a restitution claim with other legal proceedings, such as seeking a judicial injunction to cease further violation.[565] Another one is when it is against an unauthorised party whose conduct is connected to the restitution order against an authorised one. It is because that if the misconduct involves an unauthorised third party, as for the consideration of jurisdiction, it may be more efficient and effective to bring the restitution order before a court.[566] Thirdly, the risk of a firm dissipating its assets is another critical scenario that may lead the FCA to seek court support. When there is a concern that a firm might deplete or hide its assets to avoid performing a restitution order, the FCA may ask the court for a judicial asset-freezing injunction. This injunction prevents the firm from moving or disposing of its assets during the legal process, thereby preserving the ability to recover restitution once a judgment is made.[567] Finally, the FCA may consider going to court when it suspects that a firm will not comply with an administrative restitution order under Section 384. Although administrative powers are often sufficient, there are instances where the threat

[565] FCA, *FCA Handbook EG 11.3 The FCA's choice of powers* EG 11.3.2(1).

[566] FCA, *FCA Handbook EG 11.3 The FCA's choice of powers* EG 11.3.2(2).

[567] FCA, *FCA Handbook EG 11.3 The FCA's choice of powers* EG 11.3.2(3).

of judicial action is necessary to ensure compliance. For example, the FCA may choose to take an action with court to enforce a restitution order if a firm disregarded it because court orders carry the weight of legal authority, and non-compliance with such orders can result in serious consequences, such contempt of court.[568]

4.2.2.2 Section 384 Enforcement: The FCA's Proactive Administrative Power

Under Section 384, the FCA can have an administrative authority to independently deal with market abuse and compensate investor harm. This contrasts with Section 383, which can be unpredictably shaped by the court. A notable example of the FCA's proactive enforcement under Section 384 is the Tesco market abuse case (*Tesco*), as we have mentioned in Section 4.2.2.[569]

Section 384 grants the FCA the authority to impose compensation schemes where investors have been harmed by market abuse. Unlike Section 383, Section 384 provides an administrative proceeding, bypassing the need for court involvement.

[568] FCA, *FCA Handbook EG 11.3 The FCA's choice of powers* EG 11.3.2(4).

[569] FCA, *Final Notice, Tesco plc*, note 558.

Comparatively, this provision's primary benefit is its capacity to effectively and directly compensate harmed investors. For example, in *Tesco*, the FCA used Section 384 to implement a compensation scheme and required Tesco to compensate investors who purchased its shares or bonds during the period from 29 August 2014 to 22 September 2014.[570] The scheme was estimated to cost around £85 million, plus interest, a sum that was to be supervised by KPMG.[571] *Tesco* illustrates how Section 384 can be used by the FCA as a more proactive tool for market regulation. While the outcomes may be similar to those under Section 383, the use of Section 384 enables the FCA to focus more directly on investor protection and market restoration.

Thus, this approach sends a clear message that the FCA is able to be committed to solely taking action to compensate harmed investors and hold market participants accountable for their misconduct.

However, concerns were raised regarding the sufficiency and scope of the compensation scheme under Section 384. It is because that in *Tesco*, some investors remained dissatisfied or were excluded from the compensation scheme's coverage.

[570] <http://kpmg.co.uk.s3-website-eu-west-1.amazonaws.com/tesco-scheme.> accessed 15 April 2025.

[571] Ibid.

Specifically, a significant number of claimants held their securities through the CREST electronic settlement system,[572] and in such a holding structure, investors hold their securities indirectly via custodians and do not necessarily appear as the legal ownership on the securities register.[573] Therefore, under the compensation scheme, these indirect holders were not automatically eligible for compensation. Consequently, a group of harmed investors filed a Section 90A lawsuit against Tesco.

In this case, the court focused on the statutory language referring to “any interest in securities” when interpreting Section 90A.[574] This term was interpreted broadly to include both indirect proprietary interests and contractual rights arising directly under securities agreements. The court clarified that the scope of protection under Section 90A extends to ultimate beneficial owners who hold securities through a custodial chain. These end-investors, although not registered as legal holders, are recognised as having a legitimate interest in the securities and are entitled to statutory protection.[575]

[572] Certificateless Registry for Electronic Share Transfer.

[573] Louise Gullifer and Jennifer Payne, ‘Intermediated Securities: The European Perspective’ in Johannes H Binder and Paolo Saguato (eds), *The Law and Regulation of Financial Market Infrastructure: A Trans-Atlantic Perspective on Securities and Derivatives Markets* (OUP 2020) <https://ssrn.com/abstract=3580801> accessed 28 May 2025.

[574] FSMA 2000, sch 10A Part 3 8(3),

[575] *SL Claimants v Tesco Plc* [2019], note 45.

Therefore, while Section 384 provides proactive and timely compensation, the fact that a group of investors in the Tesco case pursued a claim under Section 90A suggests that Section 384 still requires refinement.

4.3 Compensation for Investors' Loss from FCA Securities Enforcement: FCA-Led Settlement (Administrative Settlement)

An FCA-led administrative settlement leverages the regulator's enforcement authority—particularly the deterrent effect of potential penalties—to incentivise early cooperation and remediation by firms. When firms under investigation admit misconduct, assist with inquiries, and provide compensation to harmed investors, they may be granted penalty discounts.

4.3.1 Legal Sources of FCA-Led Administrative Settlement

A robust legal framework governs the FCA's administrative settlement process, consisting of the *FCA Handbook* and the FSMA 2000. The FCA has extensive enforcement authority under the FSMA 2000, including the capacity to issue warning, decision, and final notices—all crucial steps in the settlement process.[576] Additionally, the *FCA Handbook* provides more specific information about the enforcement regulations and settlement

[576] FSMA 2000 s 387, s 388, and s 390.

procedures, and DEPP 5 is one of the *Handbook*'s sections that is essential to comprehending the FCA's settlement approach.[577]

4.3.2 Voluntary Compensation

A defining element of these settlements is the availability of penalty discounts, designed to incentivise timely cooperation.[578]

The penalty discount is objectively substantial—large enough to incentivise firms to opt for an expedited settlement to minimise penalties and collateral costs.

For example, in the 2015 FCA enforcement action against Asia Resource Minerals plc (ARM),[579] the company faced investigation following its acquisition of Indonesian coal assets, after allegations emerged of undisclosed related-party transactions involving a former director. $12 million in undisclosed transactions were found during an internal review, which violated Listing Principle 2 and UK Listing Rules. In this case, under the pressure of the FCA's penalty, ARM proactively participated in the investigation and admission of misconduct, and in the end, the FCA's initial £6.6 million penalty was subsequently lowered by 30% to £4.65 million.

577 FCA, *FCA Handbook DEPP 5.1 Settlement Decision Makers*.

578 FCA, *FCA Handbook DEPP 6.7 Discount for Early Settlement*.

579 FCA, *Final Notice, Asia Resource Minerals plc (formerly Bumi plc)*, 12 June [2015].

Given the strong appeal of penalty discounts to firms, providing voluntary compensation to those who are harmed is often a key pathway to securing such reductions. As data shows, in 2021/22 and 2022/23, companies voluntarily repaid £23.5 million and £4 million, respectively, to investors harmed by misconduct.[580] That is, firms frequently and voluntarily compensate during settlements.[581]

For instance, in a hypothetical scenario, XYZ Plc admits to overstating revenues by £50 million, leading to an initial £20 million FCA fine. By cooperating early, XYZ secures a 30% reduction and establishes a £10 million compensation fund while reforming internal controls. Such measures could highlight how settlements balance accountability with efficient redress.

FCA's practice further demonstrates this mechanism, although it does relatively little in the field of securities enforcement. However, these cases are useful as regulated firms that are fined have investors who have been harmed, and such investors have benefited from settlement-led compensation. Those examples are: Equifax Limited faced a £15.9 million penalty for data security failures, mitigated to £11.2 million after a 30% discount for cooperation and a £324.5 million customer compensation scheme.[582]

[580] FCA, *FCA Operating Service Metrics 2022/23*, 48; FCA, *FCA Operating Service Metrics 2021/22*, 43.

[581] <https://www.fca.org.uk/about/how-we-regulate/enforcement/settlement-mediation-enforcement-cases.> accessed 20 April 2025.

[582] FCA, *Final Notice, Equifax Limited*, 3 October [2023].

Similarly, Julius Baer International Ltd (JBI) received a reduced £18 million fine (from £24.5 million) after addressing compliance gaps and reimbursing clients £396,000.[583] In a high-profile case, Lloyds Bank General Insurance Limited (LBGI) was fined £90.7 million (down from £129.5 million) for misleading insurance renewals affecting 9 million policies. LBGI's remedial actions, including £13.69 million in customer reimbursements, contributed to the penalty reduction.[584]

Notably, the FCA also retains authority to pursue criminal charges, encouraging cooperation through its Enforcement Guide. Factors like voluntary compensation, systemic reforms, and proactive collaboration may mitigate the chances of criminal prosecution.[585] Like the pressure of the FCA's fine, when facing the pressure of potential criminal charges, firms are also likely incentivised to offer voluntary compensation to those who are harmed.

4.3.3 FCA Enforcement: A Multidimension Legal Framework

[583] FCA, *Final Notice, Julius Baer International Limited*, 10 February [2022].

[584] FCA, *Final Notice, Lloyds Bank General Insurance Limited; St Andrew's Insurance Plc; Lloyds Bank Insurance Services Limited; and Halifax General Insurance Services Limited*, 8 July [2021]. Here is a securities misrepresentation FCA enforcement, and in this case, the penalty is a public censure instead of fine reduction. In June 2020, the FCA issued a final notice against Redcentric PLC for market abuse after it published misleading information on its debt and cash holdings in 2015 and 2016. Redcentric set up a voluntary compensation scheme for affected shareholders, and the FCA, balancing the circumstances and public interest, imposed a public censure instead of a fine. FCA, *Final Notice, Redcentric PLC*, 26 June [2020].

[585] FCA, *FCA Enforcement Guide* 12.8(8) & 12.8(10).

In summary, FCA-led administrative settlements serve as a critical mechanism for resolving regulatory violations efficiently. By combining financial penalties, compensation schemes, and early resolution incentives, the FCA ensures market transparency, investor protection, and timely justice. Notably, some approaches can avoid protracted litigation, delivering measurable outcomes while deterring future misconduct.

Among the FCA's public enforcement strategies, Sections 383, 384 and the FCA-led administrative settlement mechanism are integral tools in addressing market abuse, enforcing accountability, and able to secure compensation for harmed investors. Together, these enforcement actions are possibly to form a robust and efficient package for safeguarding investor interests and maintaining confidence in the securities market.

Firstly, Section 383 empowers the FCA to apply to an independent tribunal or court for restitution orders against those responsible for market abuse. This provision embodies a dual-arm mechanism—one administrative (the FCA's investigatory and application power) and one judicial (the tribunal's or court's decision and review)—while preserving strict separation of powers between regulator and judiciary.

In addition to restitution orders, Section 383 enables the FCA to seek ancillary remedies such as injunctions from the courts to restrain ongoing or anticipated market-abusive conduct or to freeze the assets of suspected perpetrators. For injunctions, the FCA needs to apply for them, but it is the court that independently assesses whether the statutory tests are met, thereby providing a check and balance on regulatory action. Furthermore, since the proceeding is in the court, Section 383 expands the scope of accountability. With the jurisdiction of court, it allows the FCA to target unauthorised entities, ensuring that more violators, irrespective of their formal regulatory status, are held accountable for their actions. Therefore, the legal effect of Section 383 is profound. By authorising the FCA to advocate for harmed investors, this mechanism guarantees that restitution is attainable from a large accountable scope.

Next, Section 384 grants the FCA direct authority to seek restitution from violators. This autonomy eliminates the need for court involvement, positioning the FCA as the primary decision-maker in restitution cases.

As the central regulatory authority, the FCA is well-equipped to understand the nuances of violators' behaviour and the specifics of individual cases. This familiarity allows the FCA to efficiently utilise its information and expertise to secure restitution, which shows the efficiency of Section 384 in its streamlined approach.

However, the FCA's autonomous use of Section 384, while efficient, raises important questions about due process and the separation of powers. Under Section 384, the FCA may impose restitution orders without prior judicial authorisation, relying on its own investigative findings and decision-making committee rather than an independent trial. Although the FCA's Regulatory Decisions Committee provides an internal check by separating investigation from decision-making, this process lacks the full procedural safeguards inherent in judicial proceedings, such as open hearings before an impartial court and the substantive review of law by judges. To mitigate these risks, violators retain the right to challenge any Section 384 order by appealing to the Upper Tribunal. This appeals mechanism restores an external judicial check on the FCA's administrative power, ensuring that decisions can be reviewed for legal correctness and procedural fairness.[586]

Thirdly, the FCA-led administrative settlement mechanism serves as an efficient and effective alternative to protracted legal proceedings. Through negotiated agreements, the FCA can resolve enforcement cases swiftly while ensuring accountability and forcing compensation for harmed investors.

This mechanism offers several advantages that enhance its suitability as part of a comprehensive enforcement package. One of the most significant

[586] Joanna Gray (2004), note 544, 54.

achievements of the FCA-led administrative settlement mechanism is its ability to force compensation for harmed investors. Here, the FCA-led administrative settlements is the inclusion of penalty discount provisions. Thus, when FCA-led administrative settlements exert significant fine and criminal charge-pressure on firms, firms are likely to take corrective actions, including voluntary compensation for harmed investors to mitigate penalties. Besides, these discount incentives encourage firms to cooperate with the FCA's investigative and enforcement processes, thereby avoiding prolonged uncertainty for all parties involved. Thus, by offering penalty discounts, the FCA motivates firms to accept responsibility promptly, facilitating a cooperative atmosphere that is conducive to achieving meaningful outcomes for harmed investors and the broader market.

In sum, Sections 383, 384, along with the FCA-led administrative settlement mechanism, each offer distinct advantages in addressing market abuse and protecting investor interests. While all three contribute to enforcement and restitution, their strengths lie in different areas of operation. Together, these tools safeguard investor interests, uphold market integrity, and enhance confidence in the securities market.

Aspect	Section 383	Section 384	FCA-led Settlement
Legal Framework	Requires court collaboration	Direct FCA authority	FCA-led Negotiated agreements
Speed of Resolution	Moderate, court-dependent	Faster due to direct action	Fastest, avoids litigation and put fine & criminal charge-pressure on wrongdoers
Scope of Accountability	Broad, includes unauthorized entities	Limited to FCA jurisdiction	Limited to FCA jurisdiction
Investor Compensation	Court-mandated restitution	FCA-mandated restitution	Voluntary compensation
Operational Efficiency	Reduced due to judicial involvement	High due to FCA autonomy	High, streamlined negotiation

Figure 4: Table Comparing the Key Elements of FCA Enforcement Actions

4.4 Compensation Complementarity Between FCA and Private Enforcement

4.4.1 Challenges of Private Enforcement and the Institutional Advantages of FCA Enforcement

As we have seen in Section 2 and Section 3, securities private enforcement in the U.K. poses significant challenges for harmed investors seeking compensation. Against this backdrop, FCA enforcement institutionally emerges as a predominant tool for investor compensation. Its institutional framework and enforcement mechanisms address many of the shortcomings inherent in private enforcement.[587]

Firstly, by focusing on statutory determinations of harm and compensation distribution, FCA enforcement—functioning as a statutory

[587] However, as practice indicates (see Section 4.4.2), while the institutional legal framework appears robust, this has not been effectively reflected in judicial practice.

scheme—offers potential, in contrast to the rigid civil remedies constrained by precedent, to remove barriers to collective redress to a certain extent, thereby ensuring broader and more practicable relief for harmed investors.

Back to 2014 Tesco accounting scandal, where FCA utilised Section 384, to order Tesco to establish a compensation scheme for harmed investors. However, gaps remain—certain beneficiary claims fell outside the scope of the scheme. Similar issues arise when beneficiary claims are pursued under Section 90A. The underlying challenge lies in the application of the no-look-through principle: ultimate investors holding shares through intermediaries lack a direct cause of action against listed companies, effectively excluding many retail investors from private remedies—a position that was subsequently challenged in court.

For instance, in case law, judicial reluctance to recognise penetrative rights is evident in *Secure*.[588] Here, Credit Suisse issued notes to Bank of New York Mellon, which were held in a dematerialised electronic trading system. Secure Capital, having acquired interests via RBS, argued that Credit Suisse's mismanagement of insurance-linked note documentation caused their losses. The court rejected this claim, applying the no-look-through rule to bar cross-tier claims within custody chains. It emphasised that contractual privity

[588] *Secure Capital SA v Credit Suisse AG* [2015] EWHC 388 (Comm).

limited claims to immediate parties, preventing indirect investors from suing issuers directly. The Court of Appeal affirmed this ruling, citing alignment with precedents like *Eckerle*, where indirect shareholders were denied rights to enforce claims against issuers.[589]

However, despite the court's final conclusion that Section 90A does not exclude ultimate investors from pursuing a cause of action to recover losses, this does not imply that they always have the right to sue because of the double jeopardy principle.[590] Comparatively, it is more possible to improve the FCA's institutional advantage in securing enforcement since Section 384 is not constrained by precedents (the discretion of the scope of compensation scheme). Thus, enabling penetrative (look-through) rights strategy—a concept generally absent in case law, may easily and flexibly be incorporated into future FCA enforcement.

That is, the modern securities market system in the U.K.—with its predominantly institutional structure and limited retail investor participation—reveals a gap between current market realities and established case law principles. In other words, private enforcement may not cater for the modern securities market despite the articulation in *SL Claimants v Tesco,*[591]

[589] *Eckerle v Wickeder Westfalenstahl GmbH* [2013] EWHC 68 (Ch).

[590] *SL Claimants v Tesco Plc* [2019], note 45.

[591] Ibid.

without the benefit of a full trial. Further, getting to a full trial for these claimants is itself challenging, as reflected in the *MLB Claimants* case.[592]

Second, the FCA's enforcement strategy operates on a dual framework of deterrence and incentives, rooted in legal-economic theories of cost internalisation and incentive compatibility.

On the deterrence side, fines and criminal charges make firms internalise the external costs of misconduct, reflecting Becker's principle that penalties must outweigh illicit gains to deter misconduct.[593] Based on Becker's, the FCA further employs incentive mechanisms, such as penalty discount, grounded in game theory's repeated game logic. For instance, by pre-announcing tiered discounts as incentives, the FCA encourages rational actors to cease violations early. Notably, it is a strategy mirrored in global leniency regimes. The EU's Leniency Programme, for instance, could grant generous immunity to the first cartel whistleblower and up to 50% fine reductions for subsequent cooperators.[594] Similarly, the U.S. Plea Bargaining rewards early cooperation with immunity or reduced penalties, exploiting a prisoner's dilemma dynamic to destabilise collusion.[595]

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592 *Manning & Napier Fund, Inc & Anor v Tesco* [2020] EWHC 2106 (Ch).

593 Gary S. Becker, 'Crime and Punishment: An Economic Approach' (1968) 76 Journal of Political Economy 169-217.

594 Wouter PJ. Wils, 'Leniency in Antitrust Enforcement: Theory and Practice' (2007) 30 World Competition 25, 35.

595 Russell D. Covey, 'Plea Bargaining and Price Theory' (2016) 84 Geo. Wash. L. Rev 920, 923-939.

In contrast, the U.K.'s private enforcement regime struggles with collective action failures. Without contingency fee arrangements, retail investors face an exacerbated free-rider problem: individuals avoid litigation costs while hoping to benefit from others' efforts, as theorised by Olson.[596] This mismatch between individual and collective rationality prevents the formation of a critical mass of plaintiffs, ultimately leaving many harmed investors uncompensated. In response, the FCA's public enforcement thus could institutionally fill a vital gap, combining coercive deterrence with strategic incentives to achieve regulatory outcomes unattainable through private enforcement alone. This hybrid model—balancing the stick of penalties with the carrot of cooperation—exemplifies a modern approach to financial regulation, one that prioritises systemic stability over fragmented private remedies.

In conclusion, in the U.K., FCA enforcement addresses several shortcomings inherent in private enforcement. From an institutional perspective, FCA enforcement provides a more robust framework to ensure harmed investors receive compensation.

[596] Mancur Olson, 'Collective Action' in John Eatwell, Murray Milgate and Peter Newman (eds), *The Invisible Hand* (Palgrave Macmillan 1989) 61-69 <https://doi.org/10.1007/978-1-349-20313-0_5> accessed 14 May 2025.

4.4.2 The Limited Activity of FCA and Private Enforcement in Securities Misrepresentation

In the U.K., the FCA and private enforcement mechanisms offer distinct routes for addressing securities misrepresentation. However, there is limited activity in both enforcement in practice, making it uncertain if investors are truly well-protected.

Under Section 383, the FCA has the power to take action (apply restitution orders) against market abuse, which conceptually includes securities misrepresentation. Despite this, the provision has been rarely used. As of November 2024, a search of the BAILII database revealed only two relevant results. The first, *The Data Reporting Services Regulations 2024 No. 107*,[597] was unrelated to securities misrepresentation. The second, *FCA v Da Vinci Invest Ltd*,[598] focused on other genre of market manipulation, not securities misrepresentation. Similarly, an internal FCA database search uncovered only one additional case referencing Section 383, the discontinuation of civil proceedings against Konstantinos Papadimitrakopoulos and Dimitris Gryparis, but again, this did not address securities misrepresentation. These

[597] SI 2024/107.

[598] *FCA v Da Vinci Invest Ltd* [2015] EWHC 2401 (Ch).

findings suggest that Section 383 has been largely ineffective in addressing securities misrepresentation.

Section 384 allows the FCA to independently procced a restitution order for statutory breaches, yet its application in securities misrepresentation has been limited. A search of the BAILII database identified four cases: *Chopra & Anor v Bank of Singapore Ltd & Anor*,[599] *CGL Group Ltd & Ors v The Royal Bank of Scotland Plc & National Westminster Bank Plc & Ors* (Rev. 1),[600] *Davis v Lloyds Bank Plc*,[601] and *BlueCrest Capital Management (UK) LLP v FCA*.[602] While *Chopra & Anor* mentions misrepresentation, the case involved a statutory tort under FSMA 2000, not a specific breach under Section 90 or 90A. Besides BAILII, the only significant application of Section 384 in FCA database linked to securities misrepresentation appears in the Tesco market abuse, where investors also relied on Section 90A to pursue claims. This highlights the limited utilisation of Section 384 in addressing securities misrepresentation.

Although, as Section 4.3 has shown, FCA-led administrative settlements also represent a potential avenue for compensating investors harmed by

[599] *Chopra & Anor v Bank of Singapore Ltd & Anor* [2015] EWHC 1549 (Ch).

[600] *CGL Group Ltd & Ors v The Royal Bank of Scotland Plc & National Westminster Bank Plc & Ors* [2017] EWCA Civ 1073.

[601] *Davis v Lloyds Bank Plc* [2021] EWCA Civ 557.

[602] *BlueCrest Capital Management (UK) LLP v FCA* [2023] UKUT 140 (TCC).

securities misrepresentation, their track record in providing compensation has been underwhelming. From 2013 to November 2024, among 280 notices, only 6 notices related to breaches of Listing Rules or Disclosure and Transparency Rules. These Notices are *Metro Bank PLC*,[603] *Cathay International Holdings Limited*,[604] *Asia Resource Minerals plc*,[605] *Reckitt Benckiser Group Plc*,[606] *Prudential plc*,[607] and *Lamprell plc*.[608] Notably, none of these cases involved voluntary compensation to harmed investors during settlements. This lack of enforcement volume and compensation for harmed investors runs contrary to the general strengths of FCA enforcement in other areas, raising questions whether there is any emphasis on providing restitution for securities misrepresentation.

Back to private enforcement, Sections 90 and 90A provide investors with a direct means of seeking redress for securities misrepresentation. Despite their theoretical potential, the practical application of these provisions has also been minimal.

[603] FCA, *Final Notice, Metro Bank Plc*, 12 November [2024].

[604] FCA, *Final Notice, Cathay International Holdings Limited*, 28 June [2019].

[605] FCA, *Final Notice, Asia Resource Minerals plc*, note 579.

[606] FCA, *Final Notice, Reckitt Benckiser Group Plc*, 13 January [2015].

[607] FCA, *Final Notice, Prudential plc*, 27 March [2013].

[608] FCA, *Final Notice, Lamprell plc*, 15 March [2013]. But see *Redcentric* [2020], note 584. Here although there is no such a final proprietary punishment, FCA balanced the voluntary compensation scheme and imposed a public censure.

A review of the BAILII database as of November 2024 found only two cases invoking both Sections 90 and 90A: *Various Claimants v Standard Chartered PLC*[609] and *Allianz Funds Multi-Strategy Trust & Ors v Barclays Plc*.[610] Furthermore, a marginally greater proportion of instances have involved the use of Section 90A, including *Various Claimants v G4S PLC*,[611] *Allianz Global Investors GmbH & Ors v G4S Ltd*,[612] *Omers Administration Corporation and others & Ors v Tesco Plc*,[613] and *Sharp & Other Claimants Listed in the GLO Register v Blank & Ors*.[614] However, these cases remain limited in number. Notably, no cases invoking only Section 90 have been identified, suggesting a low judicial practice concerning that provision.

Overall, both the FCA's enforcement and private enforcement under the FSMA 2000 show limited activity in addressing securities misrepresentation. On the one hand, it may mean that compensation of securities misrepresentation is seldom an issue in the U.K., or otherwise, it may mean

[609] *Various Claimants v Standard Chartered PLC* [2023] EWHC 2756 (Ch). This an ongoing case which involves a significant class action brought by 226 claimants, all shareholders of Standard Chartered PLC, under Sections 90 and 90A of the FSMA 2000. The court's ruling on standing determines which claimants are permitted to continue the litigation, potentially narrowing the scope of the case or dismissing certain claims. The judge directed that the trial date be pushed back to October 2026, given the amount of work still to be done.

[610] *Allianz Funds Multi-Strategy Trust*, note 454.

[611] *Various Claimants v G4S PLC* [2023] EWHC 2863 (Ch). The parties reached a settlement in January 2024.

[612] *Allianz Global Investors GmbH*, note 444.

[613] *Omers Administration Corporation and others & Ors v Tesco Plc*, note 443.

[614] *Sharp & Other Claimants Listed in the GLO Register v Blank & Ors* [2019] EWHC 3096 (Ch). In *Sharp v Blank*, Lloyd's shareholders alleged former directors breached duties by failing to disclose HBOS's financial issues during its 2008 takeover. The High Court dismissed the claim, ruling directors acted reasonably, without misconduct, and losses stemmed from the global financial crisis, not any breach of duty.

that such market failures are not sufficiently detected and addressed. The underutilisation of relevant provisions may highlight significant shortcomings in the current institutional compensation framework. These shortcomings may necessitate a re-evaluation of the efficacy of the U.K.'s regulatory framework in delivering remedies for such claims.

4.4.3 The Complementary Roles of FCA Enforcement and Private Enforcement in Addressing Securities Misrepresentation

The FCA enforcement and private enforcement theoretically play central roles in enforcing securities law to prevent securities misrepresentation. However, both the FCA enforcement and private enforcement have been observed to show limited activity when it comes to seeking compensation for securities misrepresentation.

Viewed through the lens of complementarity, the restrained engagement of both FCA-led and private enforcement mechanisms may reflect an institutional framework calibrated to balance deterrence objectives with compensatory remedies. Here, the FCA's potential (strong deterrent powers) is intended to reduce the frequency of securities misrepresentation, thus reducing the need for extensive private enforcement and compensation. That is, in theory, if the FCA's deterrent function is sufficiently effective, investors would be less likely to suffer from misrepresentation in the first place, reducing the demand for other legal enforcement seeking compensation.

Moreover, the limitation of private enforcement mechanisms in the U.K. could arise from the perception that the FCA is already effective in discouraging market misconduct. This is evident in the limited legislative focus on improving private enforcement mechanisms, such as enhancing the provisions of Sections 90 and 90A or introducing more robust tools for securities collective action. The absence of significant reforms in this area may suggest that U.K. lawmakers have placed greater emphasis on the deterrent and potential compensatory power of the FCA, rather than on bolstering private enforcement channels for investor compensation.

This approach aligns with the overarching philosophy of the securities legal framework, which seeks to reconcile two frequently competing priorities: ensuring robust investor protection and fostering a regulatory environment conducive to economic growth.[615] In a system where the FCA's enforcement powers are seen as sufficiently strong, lawmakers may have prioritised maintaining a regulatory environment that does not overly incentivise private enforcement, which could cause disruptions to issuers and their economic activity. This may explain why U.K. legislation has not placed

[615] Carsten Gerner-Beuerle, 'The Market for Securities and Its Regulation through Gatekeepers' (2009) 23 Temple International & Comparative Law Journal 317, 356.

more emphasis on facilitating private enforcement, such as through an expansion of CPO or reforms to contingency fee arrangements, although in La Porta's analysis, private law enforcement is explained as the main reason for the U.S. securities markets' attractiveness.[616]

Notably, the practical context of this regulatory philosophy could also be understood against the backdrop of the structural challenges faced by the U.K. capital market in recent years. Since Brexit in 2016, the global competitiveness of the City of London has come under sustained pressure, particularly in its competition with New York for IPO activity.[617] In response, both HM Treasury and the FCA have explicitly prioritised "enhancing the attractiveness of U.K.'s listings" as a core policy objective—a goal that has directly shaped the trajectory of the U.K.'s securities enforcement framework.

One clear illustration of this philosophy is the government-commissioned *Hill Review* of the U.K. Listing Market, published in 2021.[618] Although its recommendations did not directly reform securities enforcement, they created a broader policy environment in which strengthening enforcement was not

[616] R La Porta et al. (2006), note 3, 27-28.

[617] <https://www.bloomberg.com/news/articles/2022-06-23/brexit-has-cost-london-a-big-chunk-of-ipo-market-share-in-europe> accessed 28 May 2025.

[618] U.K Listing Review, 3 March 2011. <https://assets.publishing.service.gov.uk/media/603e9f7ee90e077dd9e34807/UK_Listing_Review_3_March.pdf> accessed 28 May 2025.

prioritised. Instead, the emphasis has been on making listing requirements more attractive and more lenient to encourage companies to list in the U.K.

The Hill Review marked a significant policy turning point in post-Brexit reforms of the U.K. capital markets. As part of the government's wider efforts to stimulate domestic listings, a series of amendments to the U.K. Listing Rules came into effect in late 2021. These changes, led by Lord Hill, included structural reforms to the U.K. listing segments—most notably, the repositioning of the Standard Segment as a flexible platform suitable for a broader range of companies. These major reforms aim to make the U.K. listing regime more attractive. Key changes include, but are not limited to, lowering the free float requirement from 25% to 10%, reforming the prospectus regime to give the FCA discretion over when one is needed, removing the blanket ban on trading admissions without a prospectus, and exempting many public and secondary offers from prospectus requirements. Private companies can now raise funds via authorised online platforms without publishing a prospectus. These measures aim to reduce listing barriers and broaden investor participation.[619]

Three and a half years after the *Hill Review*, the FCA has now published the new U.K. Listing Rules, which will take effect on 29 July 2024. According

[619] Ibid.

to the FCA, these reforms represent the most significant overhaul of the U.K. listing regime in more than thirty years. The new rules aim to shift from a rigid system to a more flexible approach. This is intended to allow investors access to a wider range of companies while imposing fewer prescriptive requirements on issuers. It is expected to broaden the pool of eligible issuers in London and, through the introduction of more flexible obligations, strengthen the international competitiveness of U.K.-listed companies.[620]

Thus, the U.K.'s post-Brexit regulatory trajectory, firmly focused on reducing issuer compliance costs to boost competitiveness (as per the *Hill* Review and new Listing Rules), reflects a deliberate institutional calibration. This calibration prioritises market accessibility over strengthening the enforcement framework—accepting restrained activity in both FCA enforcement and private litigation as a necessary consequence of the chosen policy focus.

5. Conclusion

In the U.K., private securities enforcement, especially Sections 90 and 90A, offers harmed investors a theoretical pathway for compensation in cases of securities misrepresentation. However, significant legal and procedural barriers undermine its practical utility. Section 90, which addresses

[620] <https://www.fca.org.uk/news/statements/fca-welcomes-lord-hills-listing-review-report> accessed 28 May 2025.

misrepresentation in prospectuses and listing particulars, presents an advantage in its lack of a reliance requirement. Yet, the absence of established case law leads to ambiguous interpretations of elements applied in judicial practice, limiting its effectiveness. Similarly, Section 90A, which governs securities misrepresentation in continuing disclosures, places heavy evidentiary burdens on claimants, especially requiring proof of reliance and *mens rea*. These challenges are exacerbated by inefficiencies in collective action mechanisms, including the opt-in nature of GLO and the rigid procedural requirements for RA, rendering those causes of action underutilised and largely ineffective tools for securities private enforcement.

Public enforcement, led by the FCA, serves as a theoretical complement to private enforcement within its institution framework. Section 383 enables the FCA to pursue restitution through court-issued orders, while Section 384 allows the FCA to secure direct restitution without court involvement. Additionally, the FCA-led administrative settlement mechanism facilitates quicker resolutions and investor compensation.

The limited activity in both private and public enforcement reflects the U.K.'s regulatory philosophy, which seeks to balance comprehensive investor protection with fostering economic activity. The FCA's robust deterrent powers, including the imposition of unlimited fines and the pursuit of criminal charges, aim to reduce securities misrepresentation, thereby reducing the reliance on private enforcement. Ultimately, public and private enforcement are complementary in a manner where effective deterrence reduces misconduct, and private enforcement acts more as a supplementary mechanism.

Further, it can also be argued that the nature of investor protection is not perceived to be "antagonistic" in the U.K. in order to support the goal of promoting the competitiveness of the London Stock Exchange. Instead, investor protection is framed as emerging through processes of dialogue and peer-level engagement between issuers and institutional investors, epitomised by the U.K. Stewardship Code (2020).[621] This Code formally embeds principles of active ownership, providing institutional investors with a robust ex-ante framework.[622] Specifically, stewardship reframes investor protection as a collaborative, relational process ("stewardship"), emphasising long-term value creation.[623] This model has gained significant global traction. As Siems and Katelouzou note,[624] its diffusion exhibits both formal and informal patterns: the U.K. has emerged as a key exporter of governance norms, particularly to Asian jurisdictions with historical colonial ties. Transnational

[621] U.K. Stewardship Code 2020. <https://www.frc.org.uk/documents/5127/The_UK_Stewardship_Code_2020.pdf> accessed 29 May 2025.

[622] U.K. Stewardship Code 2020, 17.

[623] U.K. Stewardship Code 2020, 4.

[624] Dionysia Katelouzou and Mathias Siems, 'The Global Diffusion of Stewardship Codes' in Dionysia Katelouzou and Dan W Puchniak (eds), *Global Shareholder Stewardship: Complexities, Challenges and Possibilities (*CUP 2024) ch 30.

initiatives—such as those by the European Fund and Asset Management Association (EFAMA) and the International Corporate Governance Network (ICGN)—along with the formation of regional clusters, like the Korea–Japan axis, have further facilitated the informal spread of these practices. Thus, increasingly, non-US jurisdictions view such relational frameworks as a viable and competitive alternative to litigation-heavy enforcement paradigms, with the U.K. Stewardship Code serving as both archetype and catalyst for global adoption.

This chapter underscores the necessity for policymakers to consider the institutional complementarity between public and private enforcement, and the wider context shaping them, to consider the role of securities law enforcement in investor protection. Shortcomings in the private enforcement framework should not be criticised *per se* without taking into account how they complement public enforcement, as well as other public policy goals.

The U.K. is an example of dynamically balancing between a regulatory environment that prioritises investor protection and one that fosters economic competitiveness. However, this approach invites substantive critique: the enforcement regime may sacrifice investor protection to some extent. Heavy reliance on public enforcement or internal-governance mechanisms (such as U.K. Stewardship Code) shifts significant costs onto investors—particularly disadvantaging retail and ultimate investors who lack the resources to pursue compensation. Although a “pro-issuer” orientation can logically reduce compliance costs, improve financing efficiency, and thereby attract issuers, what must not be ignored is that a securities market is composed of both issuers and investors. Thus, regulatory frameworks must not only appeal to issuers but also protect and incentivise investors. Otherwise, they create a system in which investor protection is largely contingent on costly self-help, undermining its effectiveness and accessibility—and, by extension, jeopardising the very goal of sustaining a competitive securities market.

Chapter IV

Securities Enforcement in China

1. The Basic Institutional Framework in the Securities Law of China

1.1 The Evolution of China's Securities Legal Institution: A Four-Decade Journey

China's securities market has grown significantly in size and institutional maturity during the last four decades. As of 2022, the number of investors surpassed 200 million,[625] with 5,019 listed[626] companies and a total A-share market capitalisation reaching 82.63 trillion yuan—second globally in value.[627] These turning points show how crucial the securities market is becoming to China's economy. However, this progress has resulted from a long and complex process of institutional development, not a sudden transformation.

[625] As of February 2022, the number of investors in China exceeded 200 million. <https://finance.sina.com.cn/tech/2022-02-26/doc-imcwipih5403804.shtml> accessed 25 Dec. 2024.

[626] There are a total of 5,019 listed companies in mainland China: 2,159 on the Shanghai Stock Exchange, 2,730 on the Shenzhen Stock Exchange, and 130 on the Beijing Stock Exchange. <https://news.cnstock.com/news,bwkx-202212-4998286.htm> accessed 25 Dec. 2024.

[627] As of July 2022, the market capitalisation of China's A-shares reached 82.63 trillion yuan, compared to only 22.88 trillion yuan at the end of 2012. <https://www.cs.com.cn/gppd/gsyj/202208/t20220808_6289527.html> accessed 25 Dec. 2024.

A national plan to create a securities market began to emerge as a result of China's economic reforms towards a market-based economy starting in the 1980s.[628] Subsequently, in the early 1990s, China started to establish formal trading platforms in response to the need for financial systems. The Shenzhen Stock Exchange opened in 1991 after the Shanghai Stock Exchange opened in 1990. Two categories of shares, A-shares and B-shares, were created on these exchanges. When B-shares were introduced in 1991, these markets—which had previously only been accessible to domestic investors (A-shares)—became international, enabling participation from foreigners. It demonstrated China's strategic integration into the global financial ecosystem.[629]

China's securities laws (including normative documents) were formally established in the middle of the 1990s. The Communist Party's endorsement of a socialist market economic theory gave market-oriented reforms political legitimacy. Here, the foundational normative document for securities issuance and anti-fraud measures was established in 1993 by regulations.[630]

[628] Wang Shaoguang, 'The Great Transformation: The Bidirectional Movement in China Since the 1980s' (2008) 1 Chinese Social Sciences 129, 148.（王绍光：《大转型：1980 年代以来中国的双向运动》，载《中国社会科学》2008 年第 1 期，第 148 页）

[629] He Dexu, 'The Chinese Stock Market: Current Situation, Issues, and Countermeasures' (1995) 9 Research on Financial and Economic Issues 30-31. （何德旭：《中国股票市场：现状、问题与对策》，载《财经问题研究》1995 年第 9 期， 第 30-31 页）

[630] Eg State Council, *Provisional Regulations on the Administration of Stock Issuance and Trading* (Order No 112 of the State Council of the People's Republic of China, 22 April 1993). （《股票发行与交易管理暂行条例》，国务院，中华人民共和国国务院令第 112 号，1993 年 4 月 22 日）State Council, *Provisional Measures for Prohibiting Securities Fraud* (2 September 1993). （《禁止证券欺诈行为暂行办法》，国务院，1993 年 9 月 2 日）Zang Zhifeng, 'Studying the "Decision of the Central Committee of the Communist Party of China on Some Issues Concerning the

The China Securities Regulatory Commission (CSRC) was established during that time, allowing for more uniform enforcement and the consolidation of regulatory authority.[631] Nevertheless, there were challenges in these early years due to regulatory gaps and inadequate investor protections.[632]

The enactment of China’s first comprehensive Securities Law in 1998 marked a significant advancement. The law established a fundamental legal framework, and it was guided by *DENG Xiaoping Theory*, a key ideological tenet, and was in line with international practices.[633] It also empowered regulatory authorities, and—most importantly in this initial version of the Securities Law—established the “three principles,” which would become the cornerstone of China’s securities law enforcement philosophy, as further analysed in Section 1.2. However, early enforcement revealed weaknesses, especially regarding investor compensation and deterrence of misconduct.

Establishment of a Socialist Market Economy System”’ (1994) 3 Chinese Party and Government Cadres Forum 44-45.（臧志风：《学习〈中共中央关于建立社会主义市场经济体制若干问题的决定〉》，载《中国党政干部论坛》1994 年第 3 期，第 44-45 页）

[631] Eg Jiang Daxing, ‘The “Power-Oriented” CSRC in Retreat’ (2014) (2) Law Review 39, 49.（蒋大兴：《隐退中的“权力型”证监会》，载《法学评论》2014 年第 2 期，第 49 页）

[632] Central Committee of the Communist Party of China, *Decision of the Central Committee of the Communist Party of China on Some Issues Concerning the Establishment of a Socialist Market Economy System* (14 November 1993).（《中共中央关于建立社会主义市场经济体制若干问题的决定》，中国共产党中央委员会，1993 年 11 月 14 日）

[633] Chen Yaoxian, ‘A Major Law for Nurturing and Regulating the Development of the Securities Market — On the Legislation and Features of the Securities Law of the People's Republic of China’ (1999) 2 China Finance 20-21.（陈耀先：《一部培育和规范证券市场发展的大法——谈《中华人民共和国证券法》的立法及其特色》，载《中国金融》1999 年第 2 期，第 20-21 页）

Nonetheless, the 1998 Securities Law became the cornerstone for future reforms.

The early 2000s saw the tentative rise of private enforcement mechanisms in China, intended to bolster regulatory efforts. Based on historical context, the rise of private enforcement mechanisms in China's securities market during the early 2000s was primarily driven by major corporate scandals that exposed systemic weaknesses, making it a reactive (bottom-up pressure) initiative formalised through top-down legal reforms.[634] In 2001, the Supreme People's Court acknowledged the judiciary's inability to handle the complexity of civil securities cases by issuing a notice suspending the acceptance of such claims.[635] This pause prompted reconsideration of legal procedures. By 2003, judicial interpretations clarified the litigation process for securities misrepresentation, including rules on damages, causation, and

[634] Eg In the late 1990s and early 2000s, a series of corporate scandals in China's securities market revealed severe deficiencies in disclosure and oversight mechanisms. Yinguangxia, once celebrated as a top blue-chip stock, was exposed in 2001 for fabricating financial statements and reporting fictitious exports involving implausible quantities, prices, and products. Similarly, Hongguang Shiye disclosed massive losses shortly after its 1997 IPO, having misled investors by omitting critical operational risks in its prospectus and engaging in profit fabrication and fund misuse, as confirmed by a CSRC investigation. Zhengbaiwen, on the other hand, pursued reckless national expansion without feasibility studies, inflated sales through unsustainable pricing schemes, and prematurely spent capital raised from a rights issue. By 1999, it faced insolvency, saddled with enormous losses and debt. These cases underscored systemic weaknesses in corporate governance and enforcement during China's early capital market development.

[635] Supreme People's Court, *Notice on the Temporary Suspension of the Acceptance of Civil Compensation Cases Related to Securities* (Famingchuan [2001] No 406, 21 September 2001). (《最高人民法院关于涉证券民事赔偿案件暂不予受理的通知》 最高人民法院 法明传〔2001〕406 号 2001 年 9 月 21 日）Supreme People's Court, *Minutes of the National Court Symposium on the Trial of Bond Dispute Cases* (Fa [2020] No 185, 15 July 2020). (《全国法院审理债券纠纷座谈会纪要》 最高人民法院 法〔2020〕185 号 2020 年 7 月 15 日) Supreme People's Court, *Supreme People's Court Provisions on Several Issues Concerning the Adjudication of Civil Compensation Cases for Tortious False Statements in the Securities Market* (Fashi [2022] No 2, 22 January 2022).（《最高人民法院关于审理证券市场虚假陈述侵权民事赔偿案件的若干规定》最高人民法院 法释〔2022〕2 号 2022 年 1 月 22 日）

responsibility.[636] A key requirement introduced at this stage was the use of CSRC administrative penalties as a prerequisite for initiating civil actions—a restriction later known as the "prerequisite procedure."[637]

The 2005 revision of the Securities Law addressed many limitations of the earlier framework,[638] and its emphasis shifted to actively protecting investors rather than just avoiding financial risk.[639] One significant

[636] Supreme People's Court, *Notice on Issues Related to the Acceptance of Civil Tort Disputes in the Securities Market Caused by False Representations* (Famingchuan [2001] No 43, 15 January 2002). Supreme People's Court, *Provisions of the Supreme People's Court on Several Issues Concerning the Trial of Civil Compensation Cases Arising from False Statements in the Securities Market* (Fashi [2003] No 2, 1 February 2003). （《最高人民法院关于受理证券市场因虚假陈述引发的民事侵权纠纷案件有关问题的通知》 最高人民法院 法明传〔2001〕43 号 2002 年 1 月 15 日）（《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》 最高人民法院 法释〔2003〕2 号 2003 年 2 月 1 日）Meanwhile, the Securities Law—from its initial enactment—has never explicitly clarified the nature of liability for such cause of action. The law's relatively simplistic legislative approach, stating only that "if an act causes losses, the actor shall bear compensation liability in accordance with the law," risks creating ambiguities in judicial interpretation and hindering consistent application in practice. Zhao Wanyi (ed.), *Research on Legal Systems for Protecting Investor Interests in Securities Markets* (Law Press China, 2013) 233. （赵万一主编：《证券市场投资者利益保护法律制度研究》，法律出版社 2013 年版，第 233 页）Some scholars argue that, based on contractual relationships, issuers bear information disclosure obligations. Under Chinese civil law theory, a prospectus in securities issuance is considered an invitation to offer, and thus securities misrepresentation should be governed by contract law theory. Eg Fan Jian & Wang Jianwen, *Commercial Law Studies* (4th ed., Law Press China, 2015) 259.（范健、王建文：《商法学》（第 4 版），法律出版社 2015 年版，第 259 页）The formation of this may stem from the fact that China's fraud regime is primarily discussed within the framework of civil juristic acts （法律行为）, as fraud is chiefly regarded as an improper interference with private law autonomy and the principle of party autonomy. During the formation and expression of individual free will, a party may suffer fraud from others, resulting in defects in their declaration of intent （意思表示）. Since the declaration of intent serves as the core conceptual foundation of civil juristic acts, a key concept in contract law, discussions of fraudulent conduct in legislative frameworks are often categorised under provisions addressing the validity of juristic acts. Eg Zhu Qingyu, General Theory of Civil Law (2nd ed., Peking University Press, 2016) 282. （朱庆育：《民法总论》（第 2 版），北京大学出版社 2016 年版，第 282 页）

[637] Jia Wei, 'The Genesis of Civil Liability for Tort in the Securities Market — An Analysis of the Several Provisions on the Adjudication of Civil Compensation Cases Arising from False Statements in the Securities Market' (2003) 3 Application of Law 4, 7.（贾纬：《证券市场侵权民事责任之发轫——解析《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》》，载《法律适用》2003 年第 3 期，第 7 页）

[638] Eg Ling Yun, 'An Analysis of the Several Provisions on the Adjudication of Civil Compensation Cases Arising from False Statements in the Securities Market' (2003) 3 Chinese Certified Public Accountant 10-14. （凌云：《《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》内容评析》，载《中国注册会计师》2003 年第 3 期，第 10-14 页）

[639] Zhou Zhengqing, Vice Chairman of the Financial and Economic Committee of the National People's Congress, *Explanatory Note on the Securities Law of the People's Republic of China* (Draft Amendment) — Delivered at the 15th Meeting of the Standing Committee of the 10th National People's Congress, 24 April 2005. National People's Congress Website (23 April 2015). （全国人大财政经济委员会副主任委员周正庆：关于《中华人民共和国证券法（修订草案）》的说明——

development was the sponsor system, which guaranteed higher-quality IPOs and increased issuers' intermediary responsibility.[640] Even though these initiatives increased market trust, there were still issues with enforcement, especially when it came to legal remedies.[641]

By the late 2010s, the rapid expansion of the securities market demanded further legal reform. The 2019 revision of the Securities Law marked a new phase of liberalisation and regulatory sophistication. Central to this reform was the introduction of the registration-based securities issuance system.[642]

Specifically, China's long-standing approval-based model was superseded by this important shift. Under the approval-based model, CSRC actively assessed an issuer's substantive value and investment worthiness and acted as a gatekeeper with implicit responsibility for vetting quality. That is, ex-ante regulatory judgement was given priority, which frequently led to long lines, administrative bottlenecks, and potential market distortions based on regulatory priorities.

2005 年 4 月 24 日在第十届全国人民代表大会常务委员会第十五次会议上。中国人大网 2015 年 4 月 23 日） <http://www.npc.gov.cn/zgrdw/npc/lfzt/rlyw/2015-04/23/content_1934300.htm> accessed 25 Dec. 2025.

[640] Chen Su, Chen Jie, 'An Analysis of the Effectiveness of Securities Law and Thoughts on Its Reconstruction' (2012) 5 Global Law Review 6, 17. （陈甦、陈洁：《证券法的功效分析与重构思路》，载《环球法律评论》2012 年第 5 期，第 17 页）

[641] Ibid.

[642] Li Wenli, 'Reform of the Registration System for Securities Issuance: Jurisprudential Foundations and Implementation Pathways' (2014) 5 Studies in Law and Business 115, 117. （李文莉：《证券发行注册制改革：法理基础与实现路径》，载《法商研究》2014 年第 5 期，第 117 页）

The registration-based model, in contrast, essentially reinterprets the roles: the market (investors and intermediaries) takes on the primary responsibility of evaluating an issuer's value and risks based on that information, while the regulator's primary mandate changes to ensure that disclosure is complete, consistent, and understandable. This moves the locus of substantive judgment from the regulator pre-approval to the market post-filing.[643] Moving away from an approval-based model, the new approach enabled faster listings and improved efficiency, but also increased the need for effective oversight to deter misconduct and protect investors.

Thus, private enforcement was significantly strengthened under the 2019 revision.[644] The "prerequisite procedure"[645] was abolished, allowing investors to file litigation directly under general procedural rules.[646] New judicial interpretations refined definitions of elements, improving consistency in court decisions.[647] Procedural measures were also implemented to stop

[643] Ibid.

[644] Tang Weijian, 'Research on Chinese-Style Securities Class Actions' (2020) (12) Law Science Magazine 100, 104.（汤维建：《中国式证券集团诉讼研究》，载《法学杂志》2020 年第 12 期，第 104 页）

[645] Supreme People's Court, *Several Specific Issues Regarding Current Commercial Trial Work* (24 December 2015).（《最高人民法院关于当前商事审判工作中的若干具体问题》 最高人民法院 2015 年 12 月 24 日）

[646] Supreme People's Court, *Minutes of the National Court Symposium on the Trial of Bond Dispute Cases* (Fa [2020] No 185, 15 July 2020).（《全国法院审理债券纠纷座谈会纪要》 最高人民法院 法〔2020〕185 号 2020 年 7 月 15 日) Supreme People's Court, *Supreme People's Court Provisions on Several Issues Concerning the Adjudication of Civil Compensation Cases for Tortious False Statements in the Securities Market* (Fashi [2022] No 2, 22 January 2022).（《最高人民法院关于审理证券市场虚假陈述侵权民事赔偿案件的若干规定》最高人民法院 法释〔2022〕2 号 2022 年 1 月 22 日）

[647] Eg Liao Sheng, 'Causation in Tort Liability for False Statements Inducing Price Decline' (2016) 6 Studies in Law and Business 114, 116.（廖升：《诱空虚假陈述侵权责任之因果关系》，载《法商研究》2016 年第 6 期，第 116 页）In China, liability for misrepresentation has gradually been established on the foundation of tort liability theory (with clearly defined elements for

application), with special tort liability (Eg modified allocation of the burden of proof) serving as the applicable nature of liability. Guo Feng (ed.), *Compensation for Securities Misrepresentation as a Tort* (Law Press China, 2003) 142.（郭锋主编：《虚假陈述证券侵权赔偿》，法律出版社 2003 年版，第 142 页）The type of liability under China's tort law framework directly influences the share of compensation, and how to determine the form of liability in securities misrepresentation has become a critical issue in judicial practice. Based on this study's review of Chinese court decisions (data sourced from the Peking University Law Database: https://www.pkulaw.com/case), courts have imposed different forms of civil liability on various parties depending on their roles and degrees of fault. Such determinations remain inconsistent across cases, highlighting an urgent need for greater uniformity in judicial standards. The Supreme People's Court is also expected to clarify the connotation and applicable standards of this liability form in its upcoming judicial interpretation. For instance, if directors are found to have acted with scienter, they are usually held fully jointly and severally liable, such as in No (2023) Zhe 0203 Min Chu 5815 Civil Judgment（(2023）浙 0203 民初 5815 号）, No (2022) Lu 01 Min Chu 65 Civil Judgment（(2022）鲁 01 民初 65 号）, and No (2022) Hei Min Zhong 1290 Civil Judgment（(2022）黑民终 1290 号）.Furthermore, even in some cases where intent was not explicitly determined, courts imposed full joint and several liability based on the principle of presumed fault, as seen in No (2019) Liao Min Zhong 814 Civil Judgment（(2019）辽民终 814 号）. However, when directors were merely negligent, courts tended to impose proportional joint and several liability, as in No (2021) Hu Min Zhong 870 Civil Judgment（(2021）沪民终 870 号）, No (2021) Jing Min Zhong 780 Civil Judgment（(2021）京民终 780 号）, and No (2021) Min 01 Min Chu 1035 Civil Judgment（(2021）闽 01 民初 1035 号）. Independent directors are usually held supplementarily liable for minor negligence, such as in No (2016) Su 01 Min Chu 2071 Civil Judgment（(2016）苏 01 民初 2071 号）, No (2016) Su 01 Min Chu 2066 Civil Judgment（(2016）苏 01 民初 2066 号）, and again No (2016) Su 01 Min Chu 539 Civil Judgment（(2016）苏 01 民初 539 号）. For supervisors with negligence, courts have imposed proportional joint and several liability, such as in No (2021) Yue 03 Min Chu 3259 Civil Judgment（(2021）粤 03 民初 3259 号） and No (2020) Lu Min Zhong 3132 Civil Judgment（(2020）鲁民终 3132 号）. In contrast, in No (2021) Min Min Zhong 540 Civil Judgment（(2021）闽民终 540 号）, the court imposed only supplementary liability due to slight negligence. Securities service institutions are often held fully jointly and severally liable. For example, in No (2019) Zuigao Fa Min Shen 1885 Civil Ruling（(2019）最高法民申 1885 号）, the court imposed full liability without specifying the type of fault. In No (2020) Lu 01 Min Chu 3622 Civil Judgment（(2020）鲁 01 民初 3622 号）, the institution was found to have acted with scienter and was held fully jointly and severally liable. Likewise, due to gross negligence, full liability was imposed in No (2021) Chuan Min Zhong 201 Civil Judgment（(2021）川民终 201 号）, No (2021) Zhe 02 Min Chu 1160 Civil Judgment（(2021）浙 02 民初 1160 号）, No (2020) Zhe 01 Min Chu 1691 Civil Judgment（(2020）浙 01 民初 1691 号）, and No (2020) Chuan Min Zhong 293 Civil Judgment（(2020）川民终 293 号）. When the institution's conduct constituted ordinary negligence, courts generally imposed proportional joint and several liability, as in No (2024) Lu Min Zhong 667 Civil Judgment（(2024）鲁民终 667 号）, No (2024) Xin Min Zhong 61 Civil Judgment（(2024）新民终 61 号）, No (2021) Lu 01 Min Chu 1326 Civil Judgment（(2021）鲁 01 民初 1326 号）, No (2021) Zhe Min Zhong 389 Civil Judgment（(2021）浙民终 389 号）, No (2021) Hu 74 Min Chu 1368 Civil Judgment（(2021）沪 74 民初 1368 号）, No (2020) Hu Min Zhong 666 Civil Judgment（(2020）沪民终 666 号）, and No (2019) Chuan 01 Min Chu 1626 Civil Judgment（(2019）川 01 民初 1626 号）. However, in No (2020) Yue Min Zhong 1744 Civil Judgment（(2020）粤民终 1744 号）, although gross negligence was identified, the institution was still held proportionally jointly and severally liable. Similarly, in No (2022) Yu Min Zhong 872 Civil Judgment（(2022）渝民终 872 号）, despite the absence of an explicit fault determination, the court imposed proportional joint and several liability based on the facts.

malicious or meaningless litigation.[648] These reforms included regulating forward-looking statements and establishing thresholds for what qualifies as material misrepresentation.[649]

Among those reforms, a major institutional innovation was the creation of the securities special representative litigation (SRL). This opt-out collective action system allowed groups of harmed investors to pursue claims together, reducing legal costs and improving efficiency.[650] Although individuals cannot proactively initiate this opt-out collective action, the China Securities Investor Services Centre (CSISC) was designated as the initiating entity. This exclusive right to initiate aims to mitigate risks of abuse of opt-out collective action.[651]

In this brief overview, China's securities law has changed over the last four decades in a methodical and flexible manner, striking a balance between regulatory changes and the needs of an economy in transition. From basic frameworks in the 1980s to today's more mature and comprehensive system, legal reforms have consistently aimed to balance market development with

[648] Peng Bing, 'Causation in Civil Compensation for Securities False Statements: An Analysis of the New Developments in Judicial Interpretation' (2022) 5 Application of Law 54, 59.（彭冰：《证券虚假陈述民事赔偿中的因果关系——司法解释的新发展评析》，载《法律适用》2022 年第 5 期，第 59 页）

[649] Ibid.

[650] Eg Li Shuguang, 'A Comprehensive Analysis of the Kangmei Pharmaceutical Case' (2022) 2 Application of Law 118-126.（李曙光：《康美药业案综论》，载《法律适用》2022 年第 2 期，第 118-126 页）

[651] Ibid.

investor protection. Pivotal reforms include the 1998 Securities Law and its subsequent revisions in 2005 and 2019. Together, these changes have shaped a securities legal regime that is increasingly aligned with China's complex economic realities.

An overview of the development of China's Securities Law has been made in Section 1.1, setting the stage for a more in-depth examination in later sections. Sections 1.2 and 1.3 examine the core legislative principles underpinning securities regulation and the foundational mandatory disclosure framework established during the mid-1990s era. Section 2 offers an analysis of securities private enforcement and its evolutionary shifts beginning in 1998. Section 3 shifts focus to the landmark 2019 amendments of the Securities Law, critically evaluating the implementation of innovative mechanisms such as the SRL. Section 4 shows the regulatory dynamics between the CSRC and securities private enforcement.

1.2 Theoretical Basis of Securities Enforcement in China's Securities Law: The "Three Principles"

Prior to the 2019 Securities Law, the principles of openness, fairness, and justice were embedded in China's regulatory framework, first appearing in Article 4 of the *Provisional Measures on Convertible Bonds* in 1997,[652] and

[652] Securities Commission of the State Council, 'Article 4 of the Provisional Measures for the Administration of Convertible Corporate Bonds' (Zhengwei Fa [1997] No 16, 8 March 1997). （《可

were later formally enshrined in the 1998 Securities Law. These Three Principles have since remained central to the evolution and application of Chinese securities laws.

Openness （公开） is designed to ensure transparent market operations through accurate, complete, and timely information disclosure.[653] Firstly, this principle requires issuers to share all material information that could influence investor decisions, thereby promoting informed and equal participation in the market.[654] It also supports the role of regulatory bodies in maintaining macroeconomic stability during market fluctuations. Besides, intermediaries such as auditors, lawyers, and investment banks act as gatekeepers, verifying and reinforcing the credibility of disclosed information. Lastly, regulators, for their part, construct institutional frameworks that govern disclosure duties, aiming to detect and deter fraud and manipulation, ultimately fostering a stable and trustworthy environment for investment.[655]

Fairness （公平）focuses on ensuring equal treatment for all market participants.[656] For instance, all investors, regardless of whether they are

转换公司债券管理暂行办法》第 4 条 国务院证券委员会(已变更) 证委发〔1997〕16 号 1997 年 3 月 8 日）

[653] Li Qi, 'The Principle of Transparency in Securities Legislation' (1994) (12) Legal Science 39, 40.（李麒：《证券立法中的公开原则》，载《法学》1994 年第 12 期，第 40 页）

[654] Ibid.

[655] Gao Jingzhong, Wang Yuanyuan, 'The Evolution of China's IPO System and Reform Insights' (2018) 23 Finance and Accounting Monthly 161,162.（高敬忠、王媛媛：《中国 IPO 制度的变迁及改革启示》，载《财会月刊》2018 年 23 期，第 162 页）

[656] Zhao Wanyi, Zhao Shuyao, 'What Kind of Securities Law Does China Need?' (2018) 1 Journal of Jinan University (Philosophy and Social Sciences Edition) 67, 72.（赵万一、赵舒窈：

institutional or retail, deserve equitable access to market information and investment opportunities.[657] Similarly, issuers and investors must engage in transactions freely and without coercion.[658] In legal enforcement, fairness prohibits insider trading, fraudulent practices, and the abuse of market dominance.[659]

Justice（公正） serves as the guiding principle for regulatory and legal actions in the securities market.[660] It emphasises the importance of fair conduct by regulators, even though they do not directly engage in trading or issuance.[661] For example, justice requires that rules be impartial and evenly applied, laying a foundation for transparent, efficient, and equitable markets. Because inconsistent penalties or interventions can undermine market confidence, regulatory enforcement must adhere strictly to legal procedures to prevent arbitrariness and abuse.[662]

《中国需要一部什么样的证券法》，载《暨南学报（哲学社会科学版）》2018 年第 1 期，第 72 页）

[657] Wang Liming, 'Improvement of Civil Liability System in China's Securities Law' (2001) (4) Legal Studies 55-58.（王利明：《我国证券法中民事责任制度的完善》，载《法学研究》2001 年第 4 期，第 55-58 页）

[658] Wu Hong and Xu Zhen, 'Jurisprudential Analysis of Financial Consumer Protection' (2009) (5) Oriental Law 13, 21.（吴弘、徐振：《金融消费者保护的法理探析》，载《东方法学》2009 年第 5 期，第 21 页）

[659] Ibid.

[660] Hao Minghui, 'A Discussion on the "Three Principles of Openness" in Securities Law' (2008) 23 Legal System and Society 374.（郝明辉：《试论证券法的"三公"原则》，载《法制与社会》2008 年第 23 期，第 374 页）

[661] Liu Dahong, 'Theoretical Explanation and Legal System Construction of Equal Rules for Market Entities' (2019) (6) China Legal Science 184, 191.（刘大洪：《市场主体规则平等的理论阐释与法律制度构建》，载《中国法学》2019 年第 6 期，第 191 页）

[662] Li Shuguang, 'Discussion on Several Major Issues of the New Share Issuance Registration System Reform' (2015) 3 Political and Legal Forum 3-4.（李曙光：《新股发行注册制改革的若干重大问题探讨》，载《政法论坛》2015 年第 3 期，第 3-4 页）

At its core, China's securities regulatory framework is anchored by the principles of openness, fairness, and justice, which collectively uphold a market defined by transparency, equity, and legal integrity.

The early principles-based approach to enforcement in China—exemplified by *the 1997 Provisional Measures on Convertible Bonds*—laid a vital foundation but also introduced significant enforcement challenges.

However, this flexibility came at a cost to the judiciary, particularly when courts attempted to apply the regulations in practice. Here, judicial interpretation posed additional challenges. As China is a civil law jurisdiction, only the Supreme People's Court holds the formal authority to interpret laws through official judicial interpretations.[663] As a result, trial-level courts were tasked with applying these broad and abstract principles in complex disputes without binding precedents. Thus, this created a risk of inconsistent rulings and made it more difficult for harmed investors to succeed. Unlike enforcing a clearly defined statutory prohibition, proving a violation of a vague principle like "fairness" made consistency in judicial outcomes difficult to achieve.

[663] Eg Supreme People's Court, *Supreme People's Court Provisions on Several Issues Concerning the Adjudication of Civil Compensation Cases for Tortious False Statements in the Securities Market* (Fashi [2022] No 2, 22 January 2022).（《最高人民法院关于审理证券市场虚假陈述侵权民事赔偿案件的若干规定》最高人民法院 法释〔2022〕2 号 2022 年 1 月 22 日）

In response to these challenges, successive legislative reforms sought to translate these high-level principles into more enforceable legal provisions. This gradual codification reflects a recognition that, although foundational principles are vital to any legal system, a maturing securities market requires greater legal clarity to ensure consistent enforcement and regulatory certainty.

1.3 Mandatory Disclosure

1.3.1 Mandatory Disclosure System for Securities Issuance

In theory, mandatory disclosure in securities issuance requires companies raising funds or issuing securities publicly to fully reveal relevant information to the public. This includes details about the issuer’s financial status, the issuance plan, potential risks, and other factors.

Mandatory disclosure duties for securities issuance are codified in various legislations such as the Securities Law and Company Law. Under Articles 11, 13, and 16 of the Securities Law (2019), companies issuing stocks or bonds must file application documents, such as articles of association, prospectuses, shareholder resolutions, and financial statements. Related agreements must also be disclosed if a sponsor is involved.[664]

[664] National People’s Congress Standing Committee, *Securities Law of the People’s Republic of China* (2019 Revision), Articles 11, 13, and 16. (《中华人民共和国证券法》(2019 修订) 第 11 条 第 13 条 第 16 条)

The prospectus is one of the most important of these. It assists investors in making well-informed decisions. The Company Law (2023), in Articles 100 and 154, outlines the general requirements for a prospectus. Notably, those requirements under the Company Law mainly address disclosure for stakeholders' rights during a company's establishment phase, while the Securities Law governs disclosure for investor protection. Together, these laws form a comprehensive system for disclosure regulation.[665]

To enhance the efficiency of legal enforcement, China mandates standardised disclosure formats, as outlined by the CSRC. A lack of standardised format could hinder investors' ability to understand information effectively.[666] For example, before listing, companies must register with the

[665] National People's Congress Standing Committee*, The Company Law of the People's Republic of China* (2023), Presidential Decree No. 15 of the People's Republic of China. （《中华人民共和国公司法》（2023 修订）全国人大常委会 中华人民共和国主席令第 15 号 ）Although there is some controversy, scholars have pointed out that the Company Law (2023) and the Securities Law (2019) share overlapping regulatory functions, which may lead to conflicts in the application of certain provisions. For instance, whether Article 191 of the Company Law (2023) can also address the issue of securities misrepresentation remains a subject of debate. Zhao Xudong, *Corporate Law* (4th ed., Higher Education Press, June 2020) 312-317.（赵旭东：《公司法学》（第四版），高等教育出版社 2020 年 6 月版，第 312-317 页）Traditionally, from the perspective of legislative purpose, the "duty of care" under the Company Law differs from the "duty of care" under the Securities Law. The Company Law primarily focuses on internal corporate governance and the protection of corporate interests, with its legislative aim being to ensure that company management acts in the company's best interests while performing their duties. Shi Tiantao, *Company Law* (4th ed., Law Press China, 2019) 426.（施天涛：《公司法论》（第四版），法律出版社 2019 年版，第 426 页）

[666] CSRC*, Announcement [2015] No 32 — Disclosure Content and Format Guidelines for Publicly Issued Securities by Companies No. 1 — Prospectus* (2015 Revision) (CSRC, Announcement [2015] No 32, 1 January 2016); CSRC*, Announcement [2023] No 5 — Disclosure Content and Format Guidelines for Publicly Issued Securities by Companies No. 58 — Announcement of Application Documents for Initial Public Offerings and Listings* (CSRC, Announcement [2023] No 5, 17 February 2023); CSRC*, Announcement [2023] No 6 — Disclosure Content and Format Guidelines for Publicly Issued Securities by Companies No. 59 — Announcement of Application Documents for Securities Issuance by Listed Companies* (CSRC, Announcement [2023] No 6, 17 February 2023). （《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）中国证券监督管理委员会 中国证券监督管理委员会公告〔2015〕32 号 2016 年 1 月 1 日；《中国证券监督管理委员会公告〔2023〕5 号—关于公布公开发行证券的公司信息披露内容与格式准则第 58 号——首次公开发行股票并上市申请文件的公告》 中国证券监督管理委员会 中国证券监督管理委员会公告〔2023〕5 号 2023 年 2 月 17 日；《中国证券监督管理委员会公告〔2023〕6 号—关于公布公开发行证券的公司信息披露内

CSRC. Article 23 of the Securities Law (2019) requires issuers to publicly disclose issuance documents after registration and during the issuance. During the process, insider information cannot be used before official publication.[667]

Finally, issuers must allow investors sufficient time to review and understand disclosure documents. This "investor digestion time," regulated under Article 61 of *the Measures for the Administration of Securities Issuance by Listed Companies*, is essential to ensure that investors have a fair opportunity to make informed choices.[668]

1.3.2 Mandatory Continuous Information Disclosure System (Post-Issuance)

Continuous information disclosure obligates listed companies to provide investors with timely, material updates after their stock exchange listing. Recognising that a company's operational and financial status changes over time, the Securities Law mandates a structured framework to ensure issuers maintain continuous transparency through continuous information

容与格式准则第 59 号——上市公司发行证券申请文件的公告》 中国证券监督管理委员会 中国证券监督管理委员会公告〔2023〕6 号 2023 年 2 月 17 日）

[667] Securities Law (2019), Articles 23 and 86.

[668] CSRC*, the Measures for the Administration of Securities Issuance by Listed Companies* (2020 Revision) (CSRC, CSRC Order No 163, 14 February 2020), Article 61.（《上市公司证券发行管理办法》（2020 修正） 中国证券监督管理委员会 中国证券监督管理委员会令第 163 号 2020 年 2 月 14 日 第 61 条）

disclosures. Similar to disclosure at the time of issuance, continuous information disclosure must also adhere to format requirements.[669]

China's provisions on post-issuance continuous information disclosure are based on Articles 79 and 80 of the Securities Law (2019), which cover information disclosure in periodic and interim reports.[670]

Here, interim reports are supplementary to periodic ones. Companies are required to submit interim disclosures upon facing material events or substantial performance shifts that necessitate immediate public reporting.

Article 80 of the Securities Law (2019) mandates that listed companies promptly disclose 12 material events. These events are usually capable of substantially influencing stock prices or financial conditions. For example, these events include significant changes in business policy or scope, large-scale asset transactions exceeding 30% of total assets, and critical contracts, guarantees, or related-party dealings that impact financial health. Other notable scenarios involve failures to meet major debt obligations, substantial

[669] CSRC*, Disclosure Content and Format Guidelines for Publicly Issued Securities by Companies No. 2 — Content and Format of Annual Reports* (2021 Revision) (CSRC, Announcement [2021] No 15, 28 June 2021). CSRC*, Disclosure Content and Format Guidelines for Publicly Issued Securities by Companies No. 3 — Content and Format of Half-Yearly Reports* (2021 Revision) (CSRC, Announcement [2021] No 16, 28 June 2021).（《公开发行证券的公司信息披露内容与格式准则第 2 号—年度报告的内容与格式》（2021 年修订）中国证券监督管理委员会 中国证券监督管理委员会公告〔2021〕15 号 2021 年 6 月 28 日；《公开发行证券的公司信息披露内容与格式准则第 3 号—半年度报告的内容与格式》 (2021 年修订) 中国证券监督管理委员会 中国证券监督管理委员会公告〔2021〕16 号 2021 年 6 月 28 日）

[670] Securities Law (2019), Articles 79 and 80; Zhu Xiaojuan (ed.), *China's Securities Legal System* (China Democracy and Legal System Publishing House, 2020) 115.（朱晓娟主编：《中国证券法律制度》，中国民主法制出版社 2020 年版，第 115 页）

financial losses, or external shifts in operational conditions. Leadership changes, particularly affecting board members or senior management, alongside alterations in shareholder control, dividend policies, or equity structures, also qualify as material disclosures. Legal actions, regulatory penalties, or investigations affecting the company or key personnel introduce reputational and financial risks. It should be noted that based on Article 80 of the Securities Law (2019), "event" is not strictly confined to the 12 enumerated ones. While the law provides a specific list of 12 significant events requiring disclosure, it explicitly includes a residual clause (the last clause) ensuring the concept of material event remains open-ended.

2. Securities Private Enforcement in China

2.1 The Liability of Issuers for Securities Misrepresentation in China: Strict Liability

In China, strict liability for issuers means that if an investor suffers financial losses due to material misrepresentation provided by an issuer, the issuer is required to compensate the investor, regardless of whether there was any bad faith or negligence involved.

Article 85 of the Securities Law (2019) clearly outlines that issuers bear strict liability for securities misrepresentation.[671]

Firstly, the provision establishes the criteria for proving liability. To hold an issuer accountable, the plaintiff must prove that: (1) the information disclosed by the issuer contains inaccuracies, falsehoods, or significant omissions; (2) The issuer was required by law to reveal that disclosure while issuing securities.; (3) the plaintiff incurred financial losses due to their investment; and (4) there is a direct causal link between the issuer's wrongful conduct and the plaintiff's financial loss. For *mens rea*, the plaintiff does not need to demonstrate it, and the issuer is not allowed to offer a defence.[672]

The scope of the issuer's disclosure duties covers not only the documents required for securities issuance but also post-issuance disclosure. However, while issuers are responsible for all required disclosure documents, not every error or omission is automatically within the scope of their liability. In practice, defendants may argue that the alleged disclosure was immaterial, and thereby it was not significant enough to mislead investors or influence

[671] Securities Law (2019), Article 85.

[672] Shi Xiaobo, 'A Study on the Constitutive Elements of Civil Liability for False Statements in China's Securities Market' (2004) 1 Journal of Zhongnan University of Economics and Law 105, 107.（石晓波：《中国证券市场虚假陈述民事责任构成要件研究》，载《中南财经政法大学学报》2004 年第 1 期，第 107 页）

their decisions.[673] This materiality test provides a balanced approach to issuer accountability, while acknowledging reasonable limitations on their liability.

2.2 Liability for Non-Issuers in Securities Misrepresentation in China: Fault-Based (Constructive)

Although investors generally have a higher likelihood of winning lawsuits against issuers in securities misrepresentation cases due to the stricter liability imposed on issuers, the outcome does not always ensure adequate compensation for the investors. Even if plaintiffs succeed against the issuer, the issuer may lack the financial capacity to fully compensate the numerous investors' losses and pay regulatory penalties. For example, if the issuer's liability is established but the listed company is on the verge of bankruptcy, it may be unable to fulfil the full compensation owed to plaintiffs. In such cases, the group of investors may have to turn to other potentially liable parties with the ability to provide compensation, such as company executives, underwriters, or experts.

Thus, besides issuers, other liable parties include the issuer's directors, supervisors, senior executives, underwriters, controlling shareholders, and professional experts. Unlike proving issuer liability, it must be demonstrated

[673] Liao Sheng, 'Recognition of Tortious Acts in False Statement Tort Liability' (2017) 1 Legal Scholar 134, 137.（廖升：《虚假陈述侵权责任之侵权行为认定》，载《法学家》2017 年第 1 期，第 137 页）

that these parties had subjective fault (constructive fault). Articles 85 and 163 of the Securities Law (2019) explicitly establish civil liability for securities misrepresentation for these categories of defendants other than issuers.[674]

2.2.1 Directors, Supervisors, Senior Executives, and Other Directly Responsible Personnel

Under Article 85 of China's Securities Law (2019), issuers found to disclose misrepresentation may subject their directors, supervisors, senior executives, and other responsible personnel to liability.

The determination of fault for directors, supervisors, senior executives, and other directly responsible personnel depends on whether they fully exercised due diligence. This approach reflects a "floating standard" principle similar to the Section 11 of the U.S. Securities Act 1933.[675] That is, given the differing levels of involvement in disclosures, the assessment of each individual's fault requires a detailed analysis of their specific circumstances. In China, responsible personnel are primarily categorised as internal (directors, supervisors, and senior executives with active roles in the company's operations) or external directors.

[674] Securities Law (2019), Articles 85 and 163.

[675] See Chapter II Section 2.2.2.

Internal personnel, including directors, supervisors, and senior executives, are closely involved in company operations and have substantial knowledge of internal decisions and information. They are integral to drafting essential documents that shape informed decision-making. When such disclosures are found to be misrepresentative, they may defend themselves by proving either that they were not in office or that they were uninvolved in preparing or approving the misrepresentative disclosures.[676]

External directors, by contrast, operate independently rather than through active participation in operational decision-making. Their liability depends on their supervisory functions, which differ significantly from those of internal personnel.[677] However, China's legal system for independent directors remains underdeveloped, with many such directors holding primary employment elsewhere.[678] Thus, this raises questions about their capacity to serve as effective "gatekeepers" for complex disclosure processes. For this special circumstance, Article 16 of *Supreme People's Court Provisions on Several Issues Concerning the Adjudication of Civil Compensation Cases for Tortious False Statements in the Securities Market* provides specific defences

[676] Xing Huiqiang, 'Improvement of the Logic in Identifying Internal Responsible Persons for Administrative Penalties of False Statements by Listed Companies' (2022) 1 China Law Review 244, 256.（邢会强：《上市公司虚假陈述行政处罚内部责任人认定逻辑之改进》，载《中国法学》2022 年第 1 期，第 256 页）

[677] Supreme People's Court, *Judicial Interpretation* (2022), note 635, Articles 14 and 16.

[678] Huang Hui, 'Legal Obligations and Accountability of Independent Directors: International Experience and China's Solutions' (2023) 1 Chinese and Foreign Law 201, 211.（黄辉：《独立董事的法律义务与责任追究：国际经验与中国方案》，载《中外法学》2023 年第 1 期，第 211 页）

available to independent directors, offering clearer guidance for mitigating or avoiding their liability.

In summary, under Article 85, directors, supervisors, senior executives, and other responsible personnel may be held liable where they are constructively negligent or act in bad faith, and the law allows responsible parties to mitigate or eliminate their liability by demonstrating they exercised due diligence.[679]

2.2.2 Underwriters

Securities underwriters are instrumental in verifying the accuracy of information disclosed to investors. By working closely with issuers, underwriters could gain a deep understanding of the issuer's financial situation. This proximity provides underwriters with a gatekeeper's position during information disclosure.[680]

Under Article 85 of the Securities Law (2019), underwriters bear constructive fault liability, a construction of fault justified by their critical

[679] CSRC, *Administrative Penalty Decision (Shanghai Technology, Zhang Jie and 9 Other Responsible Persons)* (2010) No 13, 6 April 2010. In the case, Shanghai Technology's information disclosure violations were noted, with Chairman Cao Shuihe being held directly responsible for signing off on the 2005 semi-annual and annual financial statements at the board's decision meeting. Given that he had no involvement in off-balance-sheet funds or external guarantees prior to his term and there was no evidence showing he was aware of any undisclosed matters, he received a lighter penalty. Similarly, independent directors Wang Shoujue, Cai Xiancheng, and Ni Jingdong were also deemed directly responsible for signing off on the 2004 annual report, and the 2005 semi-annual and annual reports. However, due to their independent director status, and in the absence of evidence that they participated in or knew of any undisclosed issues, they were subject to a reduced penalty

[680] Gao Zhenxiang, 'Reform of the Direct Listing System and Its "Gatekeeper" Mechanism' (2021) 5 Finance and Economics Law Journal 139, 146.（高振翔：《直接上市制度改革及其"看门人"机制分析》，载《财经法学》2021 年第 5 期，第 146 页）

gatekeeping role and the potential for moral hazard.[681] This reflects the significant trust investors place in underwriters and the influence of their involvement on the success of securities offerings.

The reputation of an underwriter plays a crucial role in this dynamic. Reputable underwriters are seen as a sign of reliability, which increases the likelihood that investors will believe the information they get. Furthermore, an underwriter's involvement often signals promising business prospects for the issuer. Thus, this reliability and prospect ultimately raise the initial price of securities offerings. Notably, while the role of underwriter is significant, China's legal framework differentiates liability standards for issuers and underwriters. Unlike the strict liability for issuers, underwriters can defend themselves by proving they conducted thorough due diligence.[682]

The standards for underwriter due diligence are detailed in various regulations. Firstly, *the 2001 Guidelines on Principal Underwriting of Equity Offerings* outline fundamental principles for due diligence during investigations before and after securities issuance.[683] Second, *the 2003 Interim Measures on the Sponsorship System* requires underwriters to

[681] Supreme People's Court, *Judicial Interpretation* (2022), note 635, Article 17.

[682] Tang Xin, Zhang Xinyu, 'Reasonable Reliance and Defences of Sponsors in Securities Issuance' (2023) 38(4) Securities Market Herald 44, 46.（汤欣、张鑫渝：《证券发行保荐人的合理信赖及免责抗辩》，载《证券市场导报》2023 年第 38 卷第 4 期，第 46 页）

[683] CSRC*, Guidance on Issues Related to Securities Companies Engaging in the Main Underwriting Business of Stock Issuances* (CSRC [2001] No 48, 17 March 2001) (no longer in effect).（《证券公司从事股票发行主承销业务有关问题的指导意见》中国证券监督委员会 证监发〔2001〕48 号 2001 年 3 月 17 日（已失效））

impartially and independently verify the authenticity of documents.[684] Thirdly, *the 2006 Due Diligence Standards for Sponsors* further refines these requirements by distinguishing between "expert" and "non-expert" opinions in disclosure documents.[685] For expert opinions, underwriters must investigate and have reasonable grounds to believe in their authenticity. For non-expert opinions, liability arises only if the underwriters had reason to suspect inaccuracies and then failed to act. To sum up, this structured system encourages underwriters to fulfil their gatekeeping responsibilities while allowing them to mitigate liability when they adhere to due diligence duty.[686]

2.2.3 Experts (Securities Service Institutions)

Article 160 of the Securities Law (2019) defines "experts" as licensed institutions providing securities services (securities service institutions) for disclosure. However, historical interpretations of related regulatory documents from the CSRC have defined experts to include both "institutions and personnel." The current Securities Law's explicit limitation to securities

[684] CSRC*, Interim Measures for the Sponsor System of Securities Issuance and Listing* (CSRC Order No 18, 1 February 2004) (no longer in effect); CSRC, *Measures for the Administration of Sponsor Business in Securities Issuance and Listing* (2023 Revision) (CSRC Order No 207, 17 February 2023).（《证券发行上市保荐制度暂行办法》中国证券监督委员会 中国证券监督管理委员会令第 18 号 2004 年 2 月 1 日 （已失效）;《证券发行上市保荐业务管理办法》（2023 修订）中国证券监督委员会 中国证券监督管理委员会令第 207 号 2023 年 2 月 17 日）

[685] CSRC*, Guidelines for the Sponsor's Due Diligence Work (CSRC Issuance* [2006] No 15, 29 May 2006) (amended); *Guidelines for the Sponsor's Due Diligence Work* (2022 Revision) (CSRC Announcement [2022] No 36, 27 May 2022). （《保荐人尽职调查工作准则》中国证券监督委员会 证监发行字〔2006〕15 号 2006 年 5 月 29 日（被修改）;《保荐人尽职调查工作准则》（2022 修订） 中国证券监督委员会 中国证券监督管理委员会公告〔2022〕36 号 2022 年 5 月 27 日）

[686] Xing Huiqiang, 'The Standard of Diligence and Responsibility and Defenses in Securities Market False Statements' (2021) 15(5) Tsinghua Law Review 69, 78,（邢会强:《证券市场虚假陈述中的勤勉尽责标准与抗辩》，载《清华法学》2021 年第 15 卷第 5 期，第 78 页）

service institutions invites scrutiny into whether liability frameworks have shifted—specifically, whether individuals within these institutions may now bear legal duties.[687]

Experts serve as gatekeepers in the securities market. In China, those experts are various professional institutions that fulfil distinct roles in the process of disclosure: accounting firms audit financial statements; law firms ensure legal compliance; securities investment advisory institutions, financial advisors, and asset evaluation firms offer professional evaluations; credit rating agencies assess credit risks; and securities IT system service providers support the technology behind securities trading systems. Collectively, these entities facilitate informed decision-making for investors.[688]

Expert liability exhibits two key characteristics. Firstly, it is limited in scope. Unlike issuers, directors, or underwriters, securities service institutions are responsible only for specific documents within their profession. For example, information disclosure involves diverse files such as prospectuses, financial statements, and audit reports. Each type of securities service institution engages with distinct documents, and it is neither feasible nor expected for them to verify all disclosed information comprehensively.

[687] Zhu Jinqing, *Securities Law* (5th edn, Peking University Press, July 2022) 171. （朱锦清：《证券法学》（第五版），北京大学出版社 2022 年 7 月版，第 171 页）

[688] Ibid.

Accordingly, their liability is confined to the documents directly tied to their services.[689]

Second, this liability incorporates a requirement of industry-specific due diligence. While all securities service institutions must conduct due diligence, its scope of liability depends on professional standards within their professional fields. For instance, accounting firms adhere to *the Guidelines of the Certified Public Accountants Law*, particularly Article 21, which mandates compliance with professional criteria during audits and financial reporting. If accounting firms comply with such standards, they may invoke defences outlined in Article 18 of *Supreme People's Court Provisions on Several Issues Concerning the Adjudication of Civil Compensation Cases for Tortious False Statements in the Securities Market* to avoid liability under Article 163 of the Securities Law (2019).[690]

Lastly, Article 163 employs a constructive fault liability. Similar to the liability regime applicable to non-issuers under Article 85, these institutions are held liable unless they can demonstrate that they acted without fault, reinforcing their function as diligent gatekeepers in the securities market.

[689] Xing Huiqiang, 'The Boundaries of the Securities Lawyer's Duty of Care' (2021) 41(9) Commercial Economics and Management 90, 92.（邢会强：《证券律师注意义务之边界》，载《商业经济与管理》2021 年第 41 卷第 9 期，第 92 页）

[690] Supreme People's Court, *Judicial Interpretation* (2022), note 635, Article 18.

2.2.4 Controlling Shareholders and De Facto Controllers ("Dual Controllers")

Under Company Law (2023), a controlling shareholder is defined as an entity or individual owning more than 50% of a company's equity or the amount of equity can possess substantial influence over decision-making in company.[691] The Company Law (2023) also introduces the concept of a de facto controller, which may not hold formal equity but can exert control through investment relationships, contractual agreements, or other means.[692] While these terms occasionally overlap—particularly in legal contexts such as the 2003 judicial interpretation[693]—their differentiation carries little practical weight in judicial enforcement.[694]

Both controlling shareholders and de facto controllers, known collectively as dual controllers, can be held liable for securities misrepresentation. Their influence gives them access to sensitive information and the ability to manipulate disclosures, leading to market misinformation and illegal profits.[695] Under Article 85 of the Securities Law (2019), dual

[691] Song Yanyan, Sheng Zixuan, and Shen Fan, 'Research on the Standards for Identifying Controlling Shareholders' (2019) 2 Research on Multi-level Capital Markets 35, 36-38（宋彦妍，盛子轩，申凡：《关于控股股东的认定标准问题研究》，载《多层次资本市场研究》2019 年第 2 期，第 36-38 页）

[692] Company Law (2023), Article 265.

[693] Supreme People's Court, *Judicial Interpretation* (2003), note 626, art 7, para 1.

[694] Ye Min and Zhou Junpeng, 'An Analysis of the Concept of De Facto Controllers in Companies' (2007) 6 Journal of the National Prosecutors College 124-125.（叶敏，周俊鹏：《公司实际控制人概念辨析》，载《国家检察院学报》2007 年第 6 期，第 124-125 页）

[695] Zheng Yu, 'On the Legal Responsibility of Actual Controllers: Path Dependence of Public Law and the Rebirth of Private Law Concepts' (2021) 3 Finance and Economics Law Journal 3, 11.

controllers now bear a constructive fault liability, which replaced the 2014 Law's fault liability.[696] While most liable parties can use a "due diligence" defence, dual controllers must meet a higher standard. According to the Supreme People's Court's judicial interpretation, they must prove they did not use their control to instruct the company to commit misrepresentation in order to avoid liability.[697]

2.3 The Fraud-on-the-Market Theory in Judicial Interpretation

When China's legal framework for securities misrepresentation was first being developed, it had shortcomings in terms of resolving the criterion of causation for civil claims. Notably, foundational statutes such as *the General Principles of Civil Law*, *the Interim Measures for the Prohibition of Securities Fraud*, and the Securities Law did not explicitly address this issue. While the Civil Procedure Law upholds the principle of "the burden of proof rests with the plaintiff," this principle, when applied to cases of misrepresentation, seemed to directly hinder the plaintiff's ability to win the case. Therefore, other theories and principles were needed to fill this gap.[698]

（郑彧：《论实际控制人的法律责任：公法的路径依赖与私法的理念再生》，载《财经法学》2021 年第 3 期，第 11 页）

[696] Lü Chenglong, 'The Responsibility for Information Disclosure Violations Should Not Be Generalized' (2021) 3 Securities Law Review 145, 151-152.（吕成龙：《信息披露违法责任不宜概而论之》，载《证券法苑》2021 年第 3 期，第 151-152 页）

[697] Supreme People's Court, *Judicial Interpretation* (2022), note 635, Article 20, para 1.

[698] Eg Li Minghui, 'The Determination of Causation in Civil Litigation for False Statements in China and Its Implications' (2004) 4 Journal of Southwest University of Political Science and Law 62, 67.（李明辉：《我国虚假陈述民事诉讼因果关系的认定及启示》，载《西南政法大学学报》2004 年第 4 期，第 67 页）

In exploring methods to prove causality, fraud-on-the-market theory and its presumption of reliance principle emerged as key theoretical frameworks.[699] Here, the Supreme People's Court of China published *the Provisions on the Trial of Civil Compensation Cases Caused by Misrepresentation in Securities Markets*, which provided clarification of causality in securities misrepresentation under Articles 18 and 19.[700] This judicial interpretation included well-established legislative and case law from other countries, particularly the U.S., and gave priority to the use of the presumption of reliance doctrine (fraud-on-the-market theory) in order facilitate accountability.

Specifically, according to this judicial interpretation, the causality in securities misrepresentation transactions is established using a presumption of reliance mechanism. It means that investors' trading decision is presumed to be based on trust in the authenticity of market information. The presumption, like fraud-on-the-market theory, holds that investors, when engaging in securities transactions, will depend on the truthfulness and completeness of market information. Thus, once a misrepresentation is disclosed, any corresponding fluctuation in the security's price presumes that

[699] Eg Liu Xinghua, 'A Study on Causation and Compensation Issues in Securities Misrepresentation' (2006) 3 Chinese Journal of Law 60, 62. （刘兴华：《证券虚假陈述的因果关系及赔偿问题研究》，载《法学研究》2006 年第 3 期，第 62 页）

[700] Supreme People's Court, *Judicial Interpretation* (2003), note 626, Articles 18.

investors relied on the disclosed information, thereby establishing transactional causation (reliance).[701]

Although debates on whether causality and losses should be established in specific cases persist, it is clear that China has adopted a relatively flexible mechanism in determining the causality of securities misrepresentation transactions.[702]

2.4 Summary

China's securities private enforcement operates under a "Unitary" liability framework. This contrasts with systems in the U.S. and U.K., where the framework of liability determinations is differentiated between primary and secondary markets. Unlike the securities private enforcement legislative models of the U.S. and U.K., China's system does not distinguish between different disclosure documents but instead differentiates based on the type of liable parties. As a result, Articles 85 and 163 of the Securities Law (2019) can be simultaneously applied to securities misrepresentation in both the primary and secondary markets.

[701] Geng Lihang, 'Reflections on the Fraudulent Market Theory' (2020) 6 Legal Studies 128, 144.（耿利航：《欺诈市场理论反思》，载《法学研究》2020 年第 6 期，第 144 页）

[702] Li Guoguang, 'On the Supreme People's Court's Provisions on the Trial of Civil Compensation Cases Arising from Misrepresentation in the Securities Market' (China Court Net, 22 November 2023) （李国光（中国法院网 2023 年 11 月 22 日）：就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》） <http://www.chinacourt.org/article/detail/2003/01/id/31512.shtml> accessed 25 Dec. 2024.

Based on the unitary liability framework, China's legislative approach to securities litigation substantially alleviates the burden of proof for investors, marking a notable departure from many other jurisdictions.

Firstly, under China's legislative approach, proving the defendant's *mens rea* is no longer a pivotal hurdle for investors. In securities misrepresentation, the intent (or scienter) of the defendant constitutes one of the most challenging elements. Particularly in jurisdictions such as the U.S., a high threshold for evidence is often required in secondary market. However, in both markets, China's framework categorises issuers under strict liability, while non-issuers operate under a constructive fault liability. This distinction means that investors are never tasked with the evidentiary burden of proving *mens rea* under any circumstance.

The implication of this design is profound. For burden of proof, strict liability ensures accountability and does not require investors to deeply know the opaque inner workings of the issuer's state of mind. Non-issuers, such as underwriters or financial advisors, face a rebuttable construction of fault. The construction shifts the burden of proof onto these parties. This legislative clarity not only protects investors but also expedites the judicial process by minimising evidentiary disputes surrounding intent.

Another hallmark of China's legislative model is the application of the fraud-on-the-market theory. This theory bridges a critical evidentiary gap by allowing investors to establish transactional causation (reliance).

Traditional models often require a direct link between the investor's reliance and the misrepresentation, and it is a demand that burdens investors with significant investigatory and legal costs. However, in the Chinese context, the fraud-on-the-market theory permits investors to demonstrate that the defendant's misrepresentations distorted market prices, which in turn misled the investor's decision. This theory alleviates the necessity for investors to show that their decisions relied on the misrepresentation. As a result, transactional causation becomes considerably easier to establish.

In conclusion, by combining strict and constructive liability with the application of the fraud-on-the-market theory in both primary and secondary markets, China's legislation forms an extremely robust investor-centric system compared to ones in the U.S. and U.K. models. Theoretically, this framework not only simplifies litigation but also empowers individual and institutional investors alike to pursue claims without daunting evidentiary hurdles.

3. The Securities Special Representative Litigation

3.1 Legislation History and Legal Sources

In recent years, China's capital market has grown quickly, drawing a large number of investors. Yet, this growth has coincided with rising incidents of investor harm due to practices like securities misrepresentation. Concurrently, even though the elements of causes of action are generally favourable to investors, challenges such as cumbersome legal procedures, exorbitant litigation costs, and low success rates in investor claims have highlighted systemic gaps in compensation. To address these issues, China implemented the Special Representative Litigation (SRL) mechanism to fortify investor protection.

3.1.1 The Background of Legislation

From 1990s, China's securities market has experienced swift growth, rising to become a globally prominent capital market by 2023. However, alongside market growth, instances of violations such as securities misrepresentation by listed companies have surged.[703]

China's investor base predominantly consists of individual investors, who are relatively disadvantaged in the market. Under traditional civil redress, individual litigation often involves high costs, lengthy procedures, and

[703] Wu Wenxin and Jiang Yongjie, 'Viewing the Formation, Change, and Development of China's Capital from the Perspective of World History' (2023) 7 Contemporary Economic Research 15-24.（吴文新、江永杰：《以世界历史眼光审视我国资本的生成、变迁与发展》，载《当代经济研究》2023 年第 7 期，第 15-24 页）

substantial difficulties, rendering it ineffective for a wide range of investors to seek damage. Although in theory class action have been widely adopted as a critical means of investor protection in securities market, such mechanism has long remained underdeveloped in China.[704]

Experiences from other jurisdictions have provided valuable templates. For instance, the U.S. securities legal framework features a well-established class action with an opt-out mechanism that effectively consolidates similar claims from investors. To some extent, the practice of it effectively deters illegal activities and compensates investors. These practices offer significant insights for China in constructing its own securities class action.[705]

Since investors could only file cases individually, there were calls to introduce a securities class action in China. Among those calls, local pilot programs for the securities class action became the primary avenue for exploring new mechanisms. In 2018, the Supreme People's Court attempted to adopt diversified resolution mechanisms to handle in several securities

[704] Eg Wang Qingsong, 'Protection of External Investors' Interests under the Mechanism of Strengthening Corporate Control' (2019) 5 Global Legal Review 143, 158-159.（汪青松：《公司控制权强化机制下的外部投资者利益保护》，载《环球法律评论》2019 年第 5 期，第 158-159 页）

[705] Zhang Wusheng, 'Model Selection and System Reconstruction of Securities Class Actions in China' (2017) 2 China Law 276, 285.（章武生：《我国证券集团诉讼的模式选择与制度重构》，载《中国法学》2017 年第 2 期，第 285 页）

misrepresentation cases, but lack of an ultimate legislative backing limited the effectiveness of these efforts.[706]

In 2019, the compilation (last stage) of the Civil Code officially began, with strengthening civil rights protection becoming a legislative focus. In this context, the SRL was placed on the legislative agenda as a critical measure to address the challenges faced by securities investors. As a result, in December of the same year, the Standing Committee of the 13th National People's Congress passed the revised Securities Law (2019), which formally introduced the SRL. This brand new civil redress grants China Securities Small and Medium Investors Service Centre (CSISC) a legal standing to initiate the SRL and file lawsuits on behalf of investors. Notably, the SRL adopts the principles of "implied participation" and "explicit withdrawal," which is a major breakthrough in China's litigation system.

Following the implementation of the Securities Law (2019), the SRL rapidly entered the practical stage. In July 2020, the Guangdong Shenzhen Intermediate People's Court accepted the first SRL case—*Kangmei Pharmaceutical*. In this case, the investor protection institutions took the lead, significantly reducing costs and enhancing efficiency, thus demonstrating the

[706] Wang Rui and Hui Yi, 'Securities False Statement Civil Liability Accountability Status and Legal Issues Research' (2019) 2 Investors 119, 128.（王蕊、回懿：《证券虚假陈述民事赔偿责任追究现状及法律问题研究》，载《投资者》2019 年第 2 期，第 128 页）

power of the rule of law.[707] The details of judicial practice will be presented in Section 3.2.

The promotion of the SRL system has been supported by the improvement of related measures. The Supreme People's Court issued judicial interpretations to clarify operational procedures, and the CSRC-supervised CSISC has become key an entity responsible for its implementation. These initiatives have facilitated the gradual transition of the SRL from exploration to maturity.[708]

3.1.2 Legal Sources

In China, the SRL serves as a critical safeguard for retail investors, and in theory, it ensures robust protection of their legal rights and financial interests. To reach these goals, the SRL is built upon a comprehensive legal framework, drawing from the Securities Law, the Civil Procedure Law, Judicial Interpretations[709], and Institutional Guidelines (normative documents).

Article 95 of the Securities Law (2019) specifically addresses the SRL. It provides that the CSISC can litigate on behalf of more than 50 investors through special authorisation. With special authorisation, the CSISC would

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707 Li Shuguang (2022), note 650, 118-126.

708 Wang Xueyu, 'Institutional Innovation and Rule Improvement of Securities Derivative Action' (2024) 3 Legal Science (Northwest University of Political Science and Law Journal) 183, 192-193.（王雪羽：《证券特别代表人诉讼的制度创新与规则完善》，载《法律科学（西北政法大学学报）》2024 年第 381 卷第 3 期，第 192-193 页）

709 Eg Supreme People's Court, *Judicial Interpretation* (2022), note 635.

be granted a legal status to participate as representatives in securities litigation. Based on the participation of the CSISC, the SRL institutionalises collective litigation for dispersed minority investors, tackling inefficiencies associated with traditional individual lawsuits such as high costs, lengthy processes, and expertise gaps.

Notably, establishing traditional representative litigation is the prerequisite to initiate the SRL. The broader framework for traditional representative litigation originates in Article 54 of the Civil Procedure Law, which establishes procedures for collective legal actions when a case involves numerous parties with the same or similar subject matter. This system is opt-in, and thereby it provides for public notice to potential plaintiffs.[710] After establishing a traditional representative litigation, whether the SRL could be established further depends on the decision from the CSISC. Here, the CSISC

[710] Feng Guo and Dou Pengjuan, 'Class Securities Civil Disputes Demonstration Lawsuit and Its Procedural Structure' (2019) 6 Investor 89, 96-102.（冯果、窦鹏娟：《群体性证券民事纠纷的示范诉讼及其程序构造》，载《投资者》2019 年第 6 期，第 96-102 页）Judicial Interpretations further clarify the application of these laws. Article 32 of *the Supreme People's Court Provisions on Securities Representative Litigation* elaborates on the integration of the Securities Law and the Civil Procedure Law. It details the conditions for initiating litigation, such as the issuance of public notices and the minimum number of authorisations required for investor protection institutions to act as representatives. These interpretations ensure that the framework is practically applicable and emphasise transparency through public notice and procedural standardisation. Supreme People's Court, *the Supreme People's Court Provisions on Securities Representative Litigation* (Fashi [2020] No 5, 31 July 2020).（《最高人民法院关于证券纠纷代表人诉讼若干问题的规定》最高人民法院 法释〔2020〕5 号 2020 年 7 月 31 日）

has issued various guidelines and templates for representative authorisation, rights holder registration, and procedural criteria.[711]

To sum up, the process of initiating an SRL involves two key stages. Firstly, traditional representative litigation should be formed, involving 50 or more plaintiffs who share the same or similar causes of action. Second, the CSISC evaluates whether to convert the traditional representative litigation into an SRL. Although the specific criteria are not detailed in the law, the CSISC guidelines provide a general framework. Key considerations include compensation for harmed investors, public interests, potential violations, and the cost of judicial resources.[712]

In summary, China's SRL system operates within a structured legal framework that includes the Securities Law, the Civil Procedure Law, Judicial Interpretations, and Institutional Guidelines. The Civil Procedure Law provides the prerequisite, a general structure for traditional representative litigation, and next the Securities Law (2019) converts this litigation into SRL. Judicial Interpretations clarify legal concepts, and other normative documents

[711] Luo Peixin and Ding Yong, 'The Legal Basis and System Design for Granting Special Rights to Investor Service Centers' (2019) 6 Investor 105, 109.（罗培新、丁勇：《赋予投服中心特殊权利的法理基础及制度设计》，载《投资者》2019 年第 6 期，第 109 页）

[712] Zhao Jinlong and Kang Ming, 'Discussion on the Case Selection Basis and Criteria of the China Securities Investor Services Center in Securities Special Representative Litigation' in *Securities Law Review* (2022 Edition, People's Court Press 2022) 507.（赵金龙、康铭：《证券特别代表人诉讼中投服中心选案基点与依据之探讨》，载《证券法律评论》（2022 年卷），人民法院出版社 2022 年版，第 507 页）

issued by the CSISC ensure efficient implementation, enhancing the SRL system's transparency and accessibility for investors.

3.2 *Kangmei Pharmaceutical*: The First Securities SRL in China

3.2.1 Securitas Misrepresentation in *Kangmei Pharmaceutical*

Kangmei Pharmaceutical Co., Ltd., founded in 1997 and listed in 2001, gained prominence in the traditional Chinese medicine sector for its rapid growth. However, in late 2018, suspicions of financial fraud surfaced. A 2019 investigation by the CSRC confirmed that from 2016 to 2018, the company falsified financial data, including inflating revenue by 29.1 billion yuan in 2017 and reporting 88.6 billion yuan in non-existent cash, misleading investors and distorting the market. Top executives, including Chairman Ma Xingtian, were found complicit in falsifying records and obstructing audits. The auditing firm, Guangdong Zhongzhong Zhujiang CPAs, was also faulted for failing to detect or report the fraud, issuing false audits without proper due diligence.

The Guangzhou Intermediate People's Court deemed the case a textbook example of securities misrepresentation. Ma Xingtian and others were ordered to pay more than 2 billion yuan in compensation, marking a record in China's capital market after the company was found guilty of misleading investors to obtain unjust benefits.[713] This case marked the first use of the SRL mechanism. The CSISC played a vital role by organising evidence, notifying investors, and coordinating litigation. The CSISC not only supported legal proceedings but also ensured that compensation was fairly calculated and distributed, adapting the litigation model as needed to protect investor rights in large-scale securities misrepresentation cases.

3.2.2 The Significance of the *Kangmei Pharmaceutical*

The significance of *Kangmei Pharmaceutical* can be analysed from multiple perspectives, particularly its profound impact on China's capital market.

Firstly, *Kangmei Pharmaceutical* exposed deeply rooted issues of corporate financial fraud within the securities market.[714] According to the investigation by the CSRC, Kangmei manipulated its financial statements through fabricated bank deposits, inflated revenues, and other financial documents, falsely increasing its 2017 revenue by 29.128 billion yuan and cash balances by 88.6 billion yuan. These fraudulent figures severely distorted the market's understanding of the company's actual operating

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[713] No (2020) *Yue 01 Min Chu 2171 Civil Judgment*.（（2020）粤 01 民初 2171 号）

[714] Huang Shizhong, 'Analysis of the Extended Issues in the Kangmei Pharmaceutical Financial Fraud' (2019) 9 Financial Accounting Monthly 3-4.（黄世忠：《康美药业财务造假延伸问题分析》，载《财会月刊》2019 年第 9 期，第 3-4 页）

conditions, leading investors to make misguided decisions and significantly undermining trust in the securities market.[715]

Second, the case significantly advanced the development of investor protection mechanisms. It highlighted the vulnerabilities of individual investors when confronted with corporate financial fraud. In this case, Guangdong Zhengzhong Zhujiang Certified Public Accountants, the independent third-party audit firm for Kangmei, failed to detect irregularities and even issued falsified unqualified audit opinions, underscoring supervisory shortcomings within the audit sector. This fraudulent conspiracy shows severe challenges that information asymmetry poses to individual investors. [716]

Thirdly, the case served as a landmark example for implementing the SRL in China. This was the first SRL case applied in China's securities market, with the CSISC acting as a representative to file collective lawsuits on behalf of thousands of investors. In this case, the SRL effectively facilitated the organisation and coordination of harmed investors and enabled centralised legal proceedings. During the trial, the CSISC's role went beyond legal representation; it also included organising, liaising, communicating, and

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[715] Ibid.

[716] Liu Xiaojuan, 'How Do Investors View the Special Representative Litigation System?—A Study on Market Reactions to Special Representative Litigation in the Kangmei Pharmaceutical Case' (2022) 3 Shanghai Finance 68, 78.（刘小娟：《投资者如何看待特别代表人诉讼制度？——基于康美药业特别代表人诉讼的市场反应研究》，载《上海金融》2022 年第 3 期，第 78 页）

assisting the court in verifying investor losses, among other critical functions.[717]

Lastly, the case shows that the compensation provided under the SRL was deemed sufficient for investors. On December 21, the first SRL executed by the CSISC commenced. A total of 52,037 investors were compensated with approximately 2.459 billion yuan through various means, including cash, debt-to-equity swaps, and trust income rights. On top of the compensation, the CSISC bore nearly all associated expenses. For claims under 500,000 yuan, full cash compensation was provided, while amounts exceeding this threshold were settled using a mix of cash, equity swaps, and trust income rights. To prevent defendants from transferring or concealing compensation, based on the Guangzhou Intermediate People's Court judgment, Kangmei Pharmaceutical transferred the funds to the China Securities Depository and Clearing Corporation, which then distributed them to investors' securities accounts via their brokerage firms.

Collectively, investors successfully received approximately 976.5 million yuan in cash, 141 million shares, and around 7.07 million units of trust income rights. Notably, among the claimants, 51,730 investors with claims under

[717] Li Na, Zhang Kuo, and Shi Guifeng, 'The Spillover Effect of China's Special Representative Litigation in Securities' (2022) 48(8) Journal of Financial Research 139, 143.（李娜、张括、石桂峰：《中国特色证券特别代表人诉讼的溢出效应》，载《财经研究》2022 年第 48 卷第 8 期，第 143 页）

500,000 yuan made up 99.41% of the total.[718] Moreover, the costs borne by plaintiffs were nearly zero. Firstly, normally plaintiffs must prepay court filing fees, provide security for asset preservation, and bear attorney fees. However, in SRL, court fees are not required upfront, and plaintiffs may apply for reductions or exemptions. Second, courts are permitted to waive the requirement for security in asset preservation applications. Thirdly, the CSISC, aside from recovering necessary expenses for litigation, is not allowed to charge other fees. All in all, this case shows the SRL provided a virtually zero-cost framework for investors, ensuring they benefit from legal redress without financial burden.[719]

In conclusion, *Kangmei Pharmaceutical* is more than a typical precedent. It has shown how China's legislation reforms the securities private enforcement by promoting transparency, deterrence and compensation. Ultimately, the legal framework is largely strengthened for robust investor protection.

3.3 The Prospective Developments for the SRL

[718] China Central Television (CCTV), 'Verdict in the First-Instance Trial of the Kangmei Pharmaceutical Class Action Case: The First Securities Class Action in China, with Investors Awarded Compensation of 2.459 Billion Yuan'（中国中央电视台报道：《康美药业集体诉讼案一审宣判——全国首例证券集体诉讼案宣判，投资者获赔 24.59 亿元》 <http://m.app.cctv.com/vsetv/detail/C11346/9d21d250f8f742a28cb5e2d27a8a52b3/index.shtml#0> accessed 25 Dec. 2024.）

[719] China Securities Investor Services Centre*, Special Representative Litigation Business Rules* (Trial Version) (2020). （《中证中小投资者服务中心特别代表人诉讼业务规则（试行）》（2020））

The SRL is partially modelled after the U.S. class action system, aiming to protect investor rights and enhance the rule of law in capital markets. However, since its introduction, several issues have emerged in practice, requiring improvements.

Firstly, since the establishment of the SRL, its practical application has been limited. As of April 2025, only four cases, *the Kangmei Pharmaceutical* (judgement passed), *the Zeda Yisheng* [720] (settled), *the Meishangshengta*[721](ongoing), and *the Jintongling*[722](ongoing), have entered the SRL process. The system's widespread adoption is severely restricted by this lack of practice.

The legislative intent behind the SRL's design is to improve the efficiency of collective investor right protection and avoid resource waste due to repetitive lawsuits. Yet five years after its implementation, a limited number of cases have progressed through the system, eroding investor confidence and expectations in its efficacy. In addition to the COVID impact, a significant contributing factor is the case selection criterion, which remain vague and restrictive, potentially excluding many otherwise viable litigation. [723]

[720] No (2023) *Hu 74 Min Chu 669 Civil Judgment.* （(2023）沪 74 民初 669 号）

[721] No (2023) *Yue 03 Min Chu 5772 Civil Judgment.* （(2023）粤 03 民初 5772 号）

[722] No (2024) S*u 01 Min Chu 2864 Civil Judgment.* （(2024）苏 01 民初 2864 号）

[723] Ding Pengchao, 'Reflection and Improvement of the Initiation Mechanism for Securities Special Representative Litigation in China' (2024) 3 Journal of Henan University (Social Science) 42-45.（丁朋超：《我国证券特别代表人诉讼启动机制的反思与完善》，载《河南大学学报（社会科学版）》2024 年第 3 期，第 42-45 页）

Additionally, limited precedents and judicial inexperience foster a cautious approach by the CSISC as it navigates uncharted territory. This conservative stance has led to a reluctance for the CSISC to initiate cases, ultimately undermining the system's goal of providing robust investor protection.[724]

Second, the SRL in China is primarily initiated by the CSISC. The CSISC's function as an initiator stands in stark contrast to the U.S. system, where class actions are usually brought by lawyers. However, due to issues related to the CSISC's institutional design (public agency) and benefit distribution (non-profit), the CSISC lacks sufficient motivation to initiate lawsuits. Specifically, while the CSISC litigates as a legal entity representing investors, its operational goals differ from the incentive mechanisms for lawyers. In the U.S. class action system, lawyers typically receive a percentage of the case's compensation, which greatly encourages lawyers to seek potential cases, organise harmed investors, and actively defend their rights. In contrast, in China, there is a lack of additional economic incentives. Moreover, since the CSISC is a non-profit and public agency, its lawsuits are primarily driven by public welfare goals and involve considerations of administrative, political, and other factors, making them more cautious when

[724] Ibid.

initiating lawsuits. Thus, this situation affects the scope and applicability of SRL.

Thirdly, one of the important features of SRL is the conversion mechanism from traditional representative litigation to SRL. The current rules are unclear about the conversion criteria, which can lead to disputes. According to Chapter 4 of *the Special Representative Litigation Business Rules (Trial),* the CSISC has significant autonomous authority in initiating the SRL. While this high degree of autonomy increases flexibility, it lacks transparency and clear standards, which may lead to external doubts about the fairness of the whole procedure.

Article 18 of *the Special Representative Litigation Business Rules (Trial)* stipulates that the CSISC can decide whether to initiate a major case evaluation meeting based on preliminary research reports, inviting independent experts to provide opinions on specific cases. However, the phrase “considering the opinions from professional opinion” shows there is unclear discretion, and thereby the final decision-making power still lies with the CSISC, lacking appropriate external constraints. In practice, this possibly results in the CSISC relying mainly on its own subjective judgment, without professional public criteria for discretion.

Furthermore, the unclear conversion standards also apply to the determination of a case's social significance. Whether the CSISC participates in a case largely depends on whether it has a "significant impact," but the standard of "significant impact" itself lacks clear quantitative indicators. For example, how should the "significance" related to the number of investors, the amount involved, or the market impact be defined? These factors are not clearly explained in the existing rules. This ambiguity in the standards can lead to subjective tendencies in case selection, reducing the objectivity and consistency of the SRL's application.

Nevertheless, the SRL offers several notable advantages. There are benefits improving the securities market's governance effectiveness and investor protection in a number of ways.

Firstly, the SRL helps reduce the risk of frivolous litigation. The SRL significantly lowers the probability of frivolous litigation, which has long been recognised as a primary side effect. In the U.S., the class action often creates opportunities for frivolous litigation, leading to increased corporate compliance costs and then decreased market efficiency. In contrast, China's SRL is designed to avoid such issues effectively.

Specifically, the system evolves from traditional representative litigation. According to the Civil Procedure Law, traditional representative litigation requires at least 50 investors to jointly file a lawsuit (clear numerosity). This high threshold ensures the collective nature and representativeness of the litigation. If the statutory number of participants is not met, qualified investors may not apply to initiate SRL. This transition mechanism not only maintains a reasonable scale of litigation but also prevents excessive or speculative filings.

Moreover, the SRL in China is led by nonprofit and public agency, the CSISC, rather than by lawyers. This institutional design eliminates profit-driven motives often seen in lawyer-led litigation, ensuring the public-interest and legitimacy of lawsuits (conflict of interest). Here, the provision requires that decisions on whether to initiate litigation are made by a nonprofit agency with consideration for the broader interests of the capital market, thereby reducing the likelihood of lawsuits driven by personal economic incentives. This arrangement objectively safeguards market stability and the financing environment but can be rather “top-down” and insufficiently cognisant of individual investors’ demands.

Second, the SRL system could be considered a new and powerful bargaining tool that enhances both the efficiency and effectiveness of dispute resolution. One of the key advantages of the SRL is its potential to empower the CSISC to resolve investor disputes more effectively. The CSISC plays a central role in this process, utilising its extensive influence and expertise to provide investors with accessible and efficient mediation services.

Even before the SRL was formally included in the Securities Law (2019), the CSISC had made significant progress in handling investor disputes. By February 2020, it had registered over 10,000 cases, with a notable 68.4% success rate among accepted claims. Through its mediation efforts, investors had recovered approximately 2.057 billion yuan in compensation, demonstrating the system's effectiveness in producing tangible outcomes, as detailed in Section 4.2.2.

Moreover, the CSISC's mediation mechanism is characterised by its accessibility, simplicity, and reliability. Institutionally, Articles 93 and 94 of the Securities Law (2019) establish the advance compensation and dispute mediation systems, respectively, thereby providing a legal foundation and institutional guarantees for dispute resolution. To further improve accessibility, the CSISC has established mediation workstations across the country and works in close cooperation with securities regulatory authorities and industry self-regulatory organisations. These efforts have created more convenient channels for investors to resolve their disputes. Therefore, compared to the initiation of a formal SRL, empowering the CSISC to use litigation as a bargaining tool offers even greater advantages in resolving disputes, as it tends to be more cost-effective and efficient for investors.

4. Examining Complementarities: Public Enforcement in Securities Legal Institutions

The CSRC was created in 1992 in response to the swift growth of the Chinese securities industry. The securities market, a vital part of the capital market, started to play a crucial role in resource allocation and fundraising during the 1980s as China's economic reforms progressed. With the founding of the Shanghai Stock Exchange and the Shenzhen Stock Exchange in 1990, China's securities market went from non-existence to emergence, and from being run on a small scale to gradually growing.[725]

To support the expanding financial sector, the CSRC was tasked, from its inception in 1992, with supervising and regulating the national securities market while ensuring enforcement of securities laws from 1992. By 1998, the CSRC was upgraded to ministerial status.[726]

Under the direct authority of the State Council, the CSRC functions as a public agency with the statutory authority to oversee all securities-related activities. As the nation's exclusive regulatory authority for securities, the

[725] Ma Hongyu and Kang Yaokun, 'Government Securities Regulation under Different Development Models of the Securities Market' (2011) 17(1) J Cent South Univ (Social Science) 60, 64.（马洪雨、康耀坤：《证券市场不同发展模式的政府证券监管》，载《中南大学学报(社会科学版)》2011 年第 17 卷第 1 期，第 64 页）

[726] Cai Zhongmin, 'An Institutional Analysis of the Financial Regulation Dilemmas in Mainland China' (2018) 61(4) China Mainland Studies 57, 61.（蔡中民：《中国大陆金融监管困境的制度性分析》，载《中国大陆研究》2018 年第 61 卷第 4 期，第 61 页）

CSRC's primary mandate, as outlined in the Securities Law, the Company Law, and related legislation, is to protect the integrity of the market and encourage the steady and long-term expansion of the securities industry in China.[727]

As for legal enforcement, the CSRC has the authority to enforce administrative laws, which include examining and approving market access, looking into and penalising violations, and creating and interpreting transaction regulations. Additionally, it can issue regulatory documents (lower-level law like normative documents) to oversee the securities markets comprehensively. These powers position the CSRC as the central entity in the regulatory framework of China's securities market.[728]

4.1 CSRC Securities Enforcement Action: Administrative Action

The Securities Law (2019) explicitly defines the legal status, powers, and responsibilities of the CSRC. According to Article 7, the CSRC possesses residual legislative and enforcement powers. It can draft and enforce implementation guidelines (lower-level normative documents) based on the existing legal framework and address legislative gaps.

[727] <http://www.csrc.gov.cn/csrc/jggk/index.shtml> accessed 10 Jan. 2025.

[728] Li Dongfang, 'Types of Securities Regulatory Enforcement and Their Normative Research' (2018) 6Administrative Law Review 19, 28-31.（李东方：《证券监管执法类型及其规范研究》，载《行政法学研究》2018 年第 6 期，第 28-31 页）

For the efficiency of legal enforcement, the CSRC adopts a centralised legal enforcement structure, collaborating with its regional offices. Article 7(2) of the Securities Law (2019) authorises the establishment of 36 CSRC regional branches nationwide, along with two regulatory offices in Shanghai and Shenzhen. Notably, the personnel in these regional offices and branches number approximately three times that of the CSRC's central staff, effectively supporting resource allocation for enforcement.

Additionally, Article 168 of the Securities Law (2019) and *the Administrative Penalty Regulations for CSRC Branch Offices* empower these regional institutions to impose administrative penalties for minor violations, which achieves a further decentralisation of regulatory enforcement.

Category	Departments/Agencies
Leadership Structure	Chairman, 4 Vice Chairmen, 1 Discipline Inspection and Supervision Team Leader (stationed at CSRC)
Administrative Penalty Committee	-
Directly Affiliated Administrative Institutions and Public Service Units	Inspection Corps, Research Centre, Information Centre, Administrative Centre
Internal Functional Departments	General Office (Party Committee Office), Comprehensive Business Department, Issuance Supervision Department, Public Company Supervision Department, Market Supervision Department I, Market Supervision Department II (Office for Rectifying and Regulating Various Trading Venues), Securities Fund Institution Supervision Department, Listed Company Supervision Department, Futures Supervision Department, Inspection Bureau, Legal Affairs Department, Administrative Penalty Committee Office, Accounting Department, International Cooperation Department (Hong Kong, Macao, and Taiwan Affairs Office), Bond Supervision Department, Technology Supervision Department, Personnel and Education Department (Party Committee Organization Department), Internal Audit Department (Party Committee Inspection Work Leading Group Office), Party Building Work Bureau (Party Committee Propaganda Department), Agency Party Committee
Discipline Inspection and Supervision Team (Stationed at	-
Dispatched Agencies (Regional Securities Regulatory Bureaus)	Beijing, Shanxi, Jilin, Jiangsu, Fujian, Henan, Guangdong, Chongqing, Yunnan, Gansu, Xinjiang, Ningbo, Shanghai, Shenzhen, Xiamen, Qingdao, Liaoning, Heilongjiang, Zhejiang, Jiangxi, Hubei, Guangxi, Sichuan, Tibet, Qinghai, Guizhou, Shaanxi, Ningxia, Dalian

Figure 1: CSRC Organisational Structure

In terms of administrative actions, Article 170 of the Securities Law (2019) specifies the measures that the CSRC can impose, including fines, warnings, confiscation of illicit gains, orders to rectify, revocation of qualifications, and suspension of operations. It should be noted that these administrative actions imposed by the CSRC, such as fines, confiscation of illegal gains, and market bans, primarily serve a deterrent and disciplinary function. Thus, they do not directly compensate investors for their financial losses.[729]

For initiating an administrative action, the enforcement of the CSRC exemplifies rigorous adherence to standardised protocols and legal principles, structured around a five-phase regulatory process:[730]

Firstly, *Informal Investigation*. Informal investigations form the foundation of enforcement efforts. Information sources include routine supervision by CSRC regional offices and leads from the "12386" hotline. Statistics show that the hotline receives over 400 reports daily, providing a wealth of data for informal investigations.[731]

Second, *Filing of a Case*. If an informal investigation reveals evidence of violations, the enforcement department (regional branches) must apply to the CSRC to file a case in accordance with Article 5 of *the Opinions on Further Strengthening Inspection and Enforcement Work by the CSRC*. Upon filing,

[729] The relevant legal provisions are derived from multiple sources, including the Securities Law (2019) (Articles 185, 192, 197, 201, and 221), *the Administrative Penalty Law of the People's Republic of China* (Articles 8 and 57), *the Regulations on the Administration of Futures Trading* (Articles 67 and 68), *the Measures for the Administration of Information Disclosure by Listed Companies* (Article 59), *the Regulations on Market Prohibition in the Securities Market* (Articles 5 and 6), and *the Interim Provisions on Reporting Securities and Futures Violations* (Article 10). These provisions collectively address regulatory compliance, penalties, disclosure obligations, market conduct, and enforcement mechanisms within China's securities and futures markets.

[730] Lü Chenglong, 'Deconstruction and Restatement of the CSRC Administrative Investigation System' (2018) 5 Securities Market Herald 72, 73-74（吕成龙：《证监会行政调查制度的解构与重述》，载《证券市场导报》2018 年第 5 期，第 73-74 页）

[731] <https://www.cs.com.cn/xwzx/hg/202001/t20200110_6016030.html?from=groupmessage> accessed 6 June 2025.

the subject of the investigation receives a Case Filing Notification, which formally shows initiating the legal accountability starts.

Thirdly, *Formal Investigation*. During this stage, the CSRC's enforcement department can exercise extensive enforcement powers under Article 179 of the Securities Law (2019). Those enforcement measures not only focus on assets transfers but also include imposing travel restrictions on potential defendants.

Fourth, *Conclusion of Investigation and Case Handover*. After concluding the investigation, the enforcement department classifies the nature of the case. Cases involving criminal offenses are transferred to the criminal judicial system.

Lastly, *Case Hearing*. The CSRC has established an independent Administrative Penalty Committee, adhering to the separation of investigation and adjudication. Based on Article 57(2) of the Administrative Penalty Law and *the Notice on Further Improving the CSRC Administrative Penalty System*, this committee determines the facts of the violation, legal application, and final outcome. Before issuing penalty decisions, the CSRC must inform the parties of their rights to make representations, defend themselves, or request a hearing.

Combing this structure with standardised enforcement phases, the "centralised and decentralised enforcement structure" model has significantly enhanced the efficiency and frequency of administrative enforcement actions, demonstrating an institutional approach that balances centralisation and decentralisation of authority. An analysis of this model can focus on three aspects: its background and growth trends, the stability brought by institutional optimisation, and the outcomes reflected in the data.

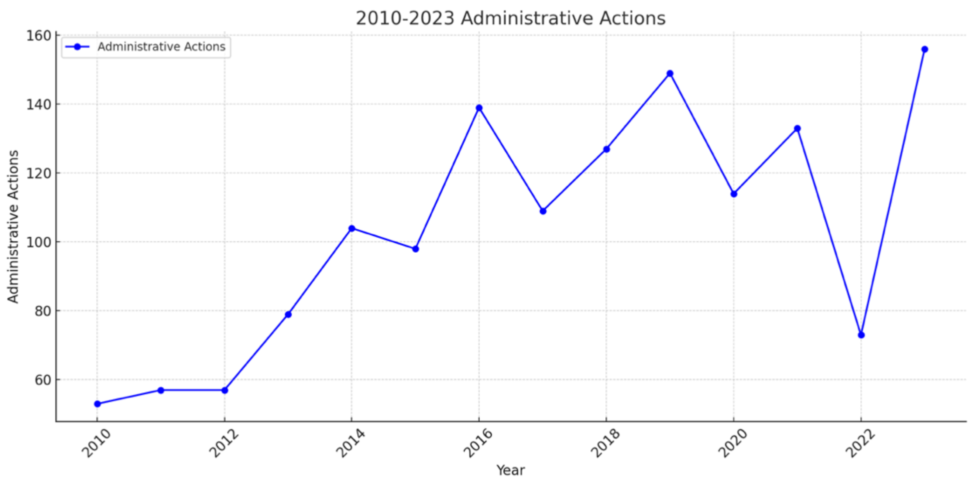

Figure 2: Volume of Administrative Actions taken by the CSRC

The implementation of the "centralised and decentralised enforcement structure" began in 2013. That year, the CSRC initiated a key reform by delegating part of its administrative enforcement powers to its local offices.

Firstly, this reform enables the two-tiered regulatory system to work well synergistically.[732] According to the data, 2013 was a definite turning point because there were 79 administrative actions issued, up 38.6% over the prior year's 57 cases. This notable expansion shows that local offices were able to directly address matters that had previously been handled by the CSRC after being given enforcement authority. Additionally, the data from 2013 to 2016 show a steady upward trend, with enforcement actions reaching 139 cases in 2016—nearly 2.5 times the pre-reform figure of 57. This trend reflects the short-term success of the reform and provides a solid foundation for further policy adjustments.[733] During the early stages of the reform, as enforcement roles were clarified and collaborative efforts intensified, local offices progressively strengthened their enforcement capacities, driving a marked increase in enforcement actions. By 2016, the annual number of enforcement decisions reached a high point and then stabilised at around 130-160 cases per year, demonstrating a relatively consistent enforcement trend. This change signifies the maturity of the enforcement mechanism and the enhancement of local offices' operational capacity.[734] Delegating responsibilities between central and local authorities fosters adaptable

[732] Du Qingqing, 'CSRC Fully Delegates Administrative Penalty Authority' (30 September 2013) China Business News Daily.（杜卿卿：《证监会全面下放行政处罚权》，载《第一财经日报》2013 年 9 月 30 日版）

[733] <http://www.csrc.gov.cn/csrc/c101971/zfxxgk_zdgk.shtml> accessed 10 Jan. 2025.

[734] Ibid.

strategies for handling diverse case scenarios. For example, complex and significant national-level cases are still handled by the CSRC, while local offices focus on regional cases. This approach not only prevents the over-centralisation of resources at the central level but also improves the timeliness of case handling.[735]

Second, this model avoids the risks associated with excessive independence of local enforcement agencies. Under the guidance and unified supervision of the central authority, local offices can independently carry out daily enforcement tasks while receiving direct support from the CSRC when dealing with complex cases or addressing issues related to enforcement standards. This strategic delegation of authority ensures uniformity in enforcement practices, addressing risks such as lenient oversight or regional passivity.[736]

In sum, the CSRC maintains the orderly functioning of China's securities market through its comprehensive regulatory mandate and a dual-tiered enforcement model blending centralised oversight with decentralised execution. These measures have established a resilient institutional

[735] Li Wenhua, 'Research on the Regulatory Enforcement Issues of Information Disclosure Violations by Listed Companies in China' (2016) 1 Southwest Finance 56, 57.（李文华：《我国上市公司信息披露违法违规监管执法问题研究》，载《西南金融》2016 年第 1 期，第 57 页）

[736] Lü Chenglong, 'Empirical Performance and Mechanism Reform of Local Enforcement by the CSRC' (2021) 4 Administrative Law Review 82, 91.（吕成龙：《证监会地方执法的绩效实证与机制改革》，载《行政法学研究》2021 年第 4 期，第 91 页）

framework that underpins the market's sustainable development and stability. We turn now to the CSRC's enforcement from the perspective of compensation.

4.2 CSRC Securities Enforcement Action: Compensation for Investors

Within China's securities regulatory framework, the CSRC and its regional branches not only impose administrative actions but also facilitate investor compensation through a multifaceted dispute resolution system. This mechanism bridges the gap in regulatory enforcement by addressing investor loss that administrative actions alone cannot remedy.

4.2.1 CSRC Civil Advance Compensation （先行赔付制度）

The development of securities markets has always been accompanied by a need for effective investor protection mechanisms. In response, the Chinese regulatory system has introduced several mechanisms aimed at safeguarding investors' rights. One such mechanism is the advance compensation system, which is designed to address the losses of investors before administrative actions conclude.[737]

[737] He Yan, 'An Analysis of Issues in the Diversified Relief System for Investors: A Perspective on the Advance Compensation System under Article 93 of the Securities Law' (2022) 8(3) Dispute Resolution 486-487.（何演：《投资者多元化救济体系问题探析——以〈证券法〉第九十三条先行赔付制度为视角》，载《争议解决》2022 年第 8 卷第 3 期，第 486-487 页）

The legal foundation of the advance compensation system in China is laid out in Article 93 of the Securities Law (2019), which authorises certain responsible parties—such as the issuer's controlling shareholders, actual controllers, and relevant securities firms—to provide compensation to investors for losses incurred due to securities law violations. Notably, this compensation occurs before any legal or administrative proceedings are concluded.

Its legal nature is rooted in civil law principles, specifically in the framework of voluntary settlement agreements. When a violation occurs, responsible parties may work with public agencies to negotiate and provide compensation to harmed investors. Importantly, investors who accept this advance compensation agree to waive any right to subsequent civil litigation concerning the same losses. This distinguishes the advance compensation system from other forms of redress, such as administrative actions (penalties) or judicial proceedings (litigation).[738] Notably, while investors receive quick relief for their financial losses, the violators are granted the legal right to seek recovery from other responsible parties or the issuer. For example, the issuer may voluntarily compensate all harmed investors (external relationship). Subsequently, however, since the misrepresentation was primarily

[738] Gong Haibin and Wang Xu, 'The Advance Compensation System in the Securities Market' (2018) 6 Financial and Economic Law Review 146, 150.（巩海滨、王旭：《证券市场先行赔付制度研究》，载《财经法学》2018 年第 6 期，第 150 页）

attributable to a particular securities service institution in this case, the issuer may seek recourse against that institution for indemnification (internal relationship). That is, the advance compensation system ensures that investors are not left without remedies while providing the violators with a path to recover the paid compensation.[739]

The advance compensation system offers several key incentives that benefit both investors and responsible parties, as well as the regulatory system at large. Firstly, it prioritises swift compensation for harmed investors. For example, by providing immediate compensation, the system helps reduce the financial burden of investors, who may otherwise face delays in accessing judicial remedies. Thus, the incentive for investors is clear: they receive a quick resolution.[740] Second, from the perspective of responsible parties, the system provides an opportunity to mitigate their legal exposure. By proactively compensating investors, violators can avoid prolonged litigation and mitigate the risk of severe administrative penalties. In practice, this incentive is built into the system through provisions that allow violators to benefit from reduced administrative penalties in exchange for their cooperation with regulators. As we have seen in Chapter III Section 4.3 (FCA

[739] Duan Binghua, ‘The Legal Logic and Institutional Implementation of Advance Compensation for Securities Investors’ (2017) 8 Securities Market Herald 4, 9.（段丙华：《先行赔付证券投资者的法律逻辑及其制度实现》，载《证券市场导报》2017 年第 8 期，第 9 页）

[740] Xiao Yu and Huang Hui, ‘Advance Compensation in the Securities Market: Jurisprudential Analysis and Institutional Construction’ (2019) 8 Law Science 160, 163.（肖宇、黄辉：《证券市场先行赔付：法理辨析与制度构建》，载《法学》2019 年第 8 期，第 163 页）

penalties discount), this system creates a balance between the interests of both parties. Investors benefit from timely compensation, while responsible parties are incentivised to reduce their legal risks by cooperating early. This mutually beneficial arrangement ensures that the regulatory process is more effective and efficient, leading to faster resolutions and a lower burden on the judicial system.[741]

Specifically, the process typically begins right after an issuer commits securities violations that result in investor losses. Once the regulator, the CSRC, identifies these violations, they may work with the responsible parties to explore the possibility of advance compensation.[742]

Violators may enter into negotiations with regulators voluntarily, during which the compensation amount is determined. All parties collaborate to evaluate the financial damages, ensuring the compensation accurately and fairly reflects the incurred losses. Investors who agree to the compensation terms have to waive their right to pursue further civil litigation for the same claims. This waiver is a crucial part of the system, as it guarantees that the

[741] Tang Xin, 'Advance Compensation in the New Regulations on Securities Investor Protection' (2020) 8 China Finance 38, 40.（汤欣：《证券投资者保护新规中的先行赔付》，载《中国金融》2020 年第 8 期，第 40 页）

[742] Peng Bing, 'Deconstructing the Civil Compensation System for Securities Misrepresentation: From Advance Compensation to Investor Compensation Funds' (2021) 1 Commercial Law Review 39-45.（彭冰：《解构证券虚假陈述的民事赔偿制度——从先行赔付到投资者补偿基金》，载《商法界论集》2021 年第 1 期，第 39-45 页）

process is final and binding, preventing the possibility of duplicate claims for the same losses.

Notably, the costs associated with the advance compensation primarily comes from the violators. This ensures that the financial burden falls on those who are directly responsible for the violations, rather than on public funds or government resources.[743]

As we have mentioned above, once the advance compensation has been provided, the parties who paid compensation may seek recovery of the amount paid from other joint-liable parties through subsequent civil proceedings (internal relationship). This recovery process encourages all defendants to actively provide the compensation because even though the compensation exceeds the defendant's liability, the defendant is able to recover that amount from other parties.[744]

To sum up, advance compensation, although brokered by the CSRC, is not formal enforcement. In terms of policy purpose, advance compensation is not purely altruistic. Rather, it is a strategic move that helps violators manage legal, financial, and reputational risks while also benefiting investors and

[743] Yuan Kang, 'Reflection and Reconstruction of the Advance Compensation System for Investor Protection Funds' (2023) 3 China Legal Science 203, 205.（袁康：《投资者保护基金先行赔付制度的反思与重构》，载《中国法学》2023 年第 3 期，第 205 页）

[744] Zheng Guan, 'Theoretical Justification of the Non-Causal Contractual Nature of Advance Compensation in the Securities Market' (2023) 1 Northern Legal Science 100, 102.（郑观：《证券市场先行赔付无因契约属性之理论证成》，载《北方法学》2023 年第 1 期，第 102 页）

regulators. By offering compensation early, they can reduce penalties, avoid prolonged litigation, and then maintain market confidence, all while preserving the opportunity to recover funds through legal means later.[745]

4.2.2 Civil Mediation （调解制度）

Mediation, a cornerstone of dispute resolution, has been elevated in legal importance under China's Securities Law. Article 94(1) of the Securities Law (2019) codifies a mandatory mediation framework for securities-related conflicts, designed to offer retail investors an accessible path to redress. In judicial practice, pre-litigation mediation procedures are commonly provided in China, offering a likelihood of settlement before formal litigation can commence.[746] However, unlike traditional pre-litigation mediation, the mandatory mediation for securities disputes does not require a mutual consent. If a retail investor opts to apply for mediation, the violators must directly proceed to mediation rather than litigation. Thus, central to this system is the legal duty imposed on CSISC and violators to engage in mediation, facilitating quicker and more effective settlements. This framework highlights a dual focus: safeguarding the rights of individual investors and

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[745] Xiao Yu and Huang Hui (2019), note 740, 163.

[746] Liu Min, 'On the Construction of the Pre-Litigation Mediation System in Civil Litigation' (2007) 13(5) J Cent South Univ (Social Science) 512-513.（刘敏：《论民事诉讼诉前调解制度的构建》，载《中南大学学报(社会科学版)》2007 年第 13 卷第 5 期，第 512-513 页）

prioritising a streamlined resolution process to enhance enforcement efficiency.[747]

A central feature of the mandatory mediation procedure is its investor-centred design philosophy. As a relatively disadvantaged group in the market, retail investors often face unfavourable positions in securities disputes.

Firstly, to address this, the procedure grants retail investors the right to prioritise entering the mediation process, while violators are obliged to participate once requested by the investor. That is, they cannot unilaterally refuse participation. This one-sided (investors) compulsory mechanism helps to balance the disparity in bargaining power between the parties and safeguard the rights of retail investors. Besides, compared to litigation, mediation offers the advantages of shorter time frames and lower costs, while leveraging the expertise of mediators to effectively reduce the complexity of disputes. This system design facilitates dispute resolution with an emphasis on fairness and efficiency.[748] It should be noted that the mandatory mediation procedure does not deprive all parties of their litigation rights but instead

[747] Fan Weiguo, 'From Supporting Litigation to Public Interest Litigation: Dilemmas and Solutions for Investor Rights Protection under the New Securities Law' (2020) 102 Financial Law Forum 143, 145.（范卫国：《从支持起诉到公益诉讼：新〈证券法〉实施下投资者权益保障的困境与出路》，载《金融法苑》2020 年总第 102 辑，第 145 页）

[748] Dong Dengxin, 'Rethinking Investor Protection under the New Securities Law' (2020) 11 Investor 3, 8.（董登新：《新〈证券法〉下投资者保护再思考》，载《投资者》2020 年第 11 期，第 8 页）

emphasises the importance of resolving disputes through non-confrontational means as a priority.[749]

Second, from the perspective of litigation resources, the complexity and technical nature of securities disputes necessitate higher levels of expertise in dispute resolution, and such a service of professional expertise is severely costly for retail investors. The CSISC's free professionalism service of the mandatory mediation aims to mitigate the cost. For instance, mediators provided by the CSISC include university professors, retired judges, senior lawyers, and industry experts. Their deep understanding of the operational mechanisms and legal frameworks of securities markets makes mediation more targeted and authoritative. To support accessibility, 35 mediation workstations have been established nationwide to provide investors with this convenient, free-of-charge mediation services. In the meantime, through the integration of mediation with litigation, courts and mediation workstations have strengthened the enforceability of mediation outcomes. Currently, 39 high courts nationwide have collaborated with mediation workstations to implement a coordinated system, ensuring the legal validity of mediation agreements through judicial confirmation.[750]

[749] Shen Wei and Jin Siyuan, 'Mediation Mechanism for Securities Disputes and Its Improvement Path under the Perspective of the New Securities Law' (2020) 2 Financial Law Forum 154, 156.（沈伟、靳思远：《新〈证券法〉视角下的证券纠纷调解机制及完善进路》，载《金融法苑》2020 年第 2 期，第 156 页）

[750] Wu Dengyong, 'Exploring New Ways to Protect the Legal Rights of Investors through the Investor Service Centre under the New Securities Law' (2021) 10 Investor 133, 136.（吴登勇：《新

Thirdly, the mediation mechanism for securities disputes has delivered significant practical results. As of the end of February 2020, the CSISC had registered 13,394 dispute cases, accepted 9,173 of them, and successfully mediated 6,277 cases. The total disputed amount reached 7.126 billion yuan, with investors receiving compensation of 2.057 billion yuan.[751] This demonstrates that the implementation of the mandatory mediation procedure has not only expedited the resolution of disputes but has also been increasingly accepted by both investors and the market.

In conclusion, the mandatory securities mediation framework is best understood as a regulator-driven public dispute resolution mechanism, administered by the CSISC. While it adopts techniques commonly found in private ADR and court-annexed mediation, its foundation is statutory, its oversight lies with the CSRC, and its funding is public. As such, it functions as a strategic instrument of public enforcement policy. Rather than representing purely private enforcement, it may be more accurately described as a hybrid public (driven) + private (mediation) enforcement mechanism. As an innovative practice under the Securities Law (2019), the mandatory mediation procedure for securities disputes achieves a balance between efficiency and fairness through its unilateral protection of retail investors'

〈证券法〉下投服中心探索保护投资者合法权益的新途径》，载《投资者》2021 年第 10 辑，第 136 页）

[751] Ibid.

rights, the professionalisation of mediation teams, and the reinforcement of mediation agreements' enforceability via multiple avenues.

4.2.3 Public Support for Civil Litigation

While civil litigation is traditionally regarded as a form of private enforcement, Articles 94(2) and 94(3) of the Securities Law (2019) reposition the CSISC as a key facilitator in this process. Notably, these provisions do not create new public enforcement powers *per se*. Rather, they strategically deploy a public agency to support and enable private enforcement actions that would otherwise face significant obstacles.

In effect, Article 94(2) helps to redress individual investors who lack of resource to litigate, while Article 94(3) lowers the evidentiary threshold by modifying the elements of the cause of action. As a result, CSISC-supported civil litigation is no longer purely a form of private enforcement; it is effectively transformed into a publicly driven, privately litigated enforcement mechanism—one in which public resources and its authority are mobilised to overcome structural barriers to investor redress.

The establishment of Articles 94(2) and 94(3) of the Securities Law (2019) provides the legal basis for CSISC to support challenging investor litigation and special derivative litigation.

Specifically, Article 94(2) grants CSISC the legal standing to support investors in initiating lawsuits. Under this provision, the CSISC is empowered to provide legal consultation services, assist in evidence collection, participate in mediation, or directly represent investors in asserting their rights during litigation. These measures reduce the manpower, financial burden, and expertise required of individual investors to engage in lawsuits.[752] For example, in the securities market, retail investors often struggle to pursue legal action when there are gaps in legal knowledge or challenges in compiling evidence. The involvement of regulators like the CSISC has partially alleviated these barriers, offering mechanisms to streamline redress and enhance accessibility for harmed investors. Systemically, this reduces the cost of investor protection and helps address the dual challenges of low legal awareness and limited resources among investors.[753]

Article 94(3) underscores the pivotal role of the CSISC within the distinct dynamics of the capital market. Under the Company Law (2023), shareholder derivative litigation is bound by stringent criteria, such as minimum shareholding percentages and mandatory holding periods. Only shareholders,

[752] Wang Xueyu (2024), note 708.

[753] Liu Weifeng and Chen Yuxin, 'Research on Issues in Special Representative Litigation under the New Securities Law: Rule Construction for Investor Protection Institutions' (2024) 1 Research on Multi-Level Capital Markets 158, 159.（刘卫锋、陈宇昕：《新〈证券法〉特别代表人诉讼问题研究——投保机构规则构建》，载《多层次资本市场研究》2024 年第 1 期（总第 18 辑），第 159 页）

either individually or collectively, who own at least 1% of a company's shares for a continuous 180-day period are permitted to initiate derivative litigation to address damage to the company's interests, according to Article 189 of the Company Law (2023). While the rule under Company Law aims to curb baseless litigation and preserve corporate governance equilibrium, it has inadvertently restricted minority shareholders' capacity to pursue judicial remedies when the company is wronged. This procedural rigidity has left certain violations of corporate interests unresolved due to systemic obstacles.[754]

In addressing this shortcoming, Article 94(3) relaxes traditional requirements by granting CSISC the legal standing to initiate derivative litigation under specific circumstances, even when the shareholding threshold and duration requirements are not met. Thus, the provision serves as a substantive supplement to the derivative litigation system since it fundamentally changes the elements. Particularly for minority shareholders, the standing for litigation is thereby established.[755]

[754] Research Group of The Chinese University of Hong Kong, 'Research on Investor Rights and Behaviors in China's Securities Market' (2021) 1 Investor 17, 31.（香港中文大学课题组：《我国证券市场投资者权益行为研究》，载《投资者》2021 年第 1 期（第 13 辑），第 31 页）

[755] Guo Li, 'Investor Protection Institutions as Active Shareholders: An Analysis Based on the Investor Service Center' (2019) 8 Law Science 148, 158.（郭雳：《作为积极股东的投资者保护机构——以投服中心为例的分析》，载《法学》2019 年第 8 期，第 158 页）

In summary, Articles 94(2) and 94(3) of the Securities Law (2019) focus on the institutional framework of CSISC and, by granting it the legal standing to support litigation and initiate derivative litigation, effectively address the challenges of high costs and difficulty in safeguarding the rights of minority shareholders.

4.3 Compensation Complementarity Between CSRC and Private Enforcement

4.3.1 The Evolution of China's Securities Enforcement: From Administrative Deterrence (Pre-2019) to Investor-Centric Mechanisms (Post 2019)

Before the 2019 revision of the Securities Law, the collective litigation in the securities market operated under a fragmented framework that lacked efficiency and legal clarity. Rooted in the Civil Procedure Law, the early system only allowed for limited forms of collective litigation—typically through mechanisms such as traditional representative litigation. Investors had to initiate their claims individually, often at significant cost and with uncertain outcomes, which severely limited the effectiveness of investor protection.

Unlike in jurisdictions such as the U.S., where class actions are common and often driven by lawyer-led initiatives, China lacked a systematic approach to consolidating claims or providing effective representation for large groups of investors. This left a significant gap in the legal landscape, with many cases resulting in protracted legal battles or, in some instances, no resolution at all. Here, this was largely due to the persistent challenges investors faced in collecting evidence, navigating procedural requirements, and obtaining expert legal advice. Consequently, the pre-2019 securities litigation framework was characterised by inefficiency, high costs, and limited accessibility.

An important turning point in the development of China's securities litigation system was the 2019 reform of the Securities Law. The amended law included the SRL as one among its many revisions. This system is designed to address the deficiencies of the earlier framework by enabling a public agency, the CSISC, to act as representatives in collective litigation. This approach is codified by Article 95 of the Securities Law (2019), which permits the CSISC to file lawsuits on behalf of over fifty investors. Under the SRL, the principles of "implied participation" and "explicit withdrawal" are pivotal (opt-out). Unless they specifically opt out, investors who satisfy the eligibility requirements are automatically included in collective litigation. This approach to some extent represents the impact of global norms, especially those of the U.S., and differs from the opt-in approaches generally employed in China's traditional legal system.

Feature	Before 2019	After the 2019 Revision of the Securities Law
Legal Framework	Fragmented framework based on the 1991 Civil Procedure Law; inefficient and legally unclear	Institutionalized framework with the introduction of the securities special representative litigation mechanism
Collective Litigation Model	Ordinary joint litigation and group litigation (opt-in)	Opt-out mechanism, where eligible investors are automatically included in collective lawsuits unless they opt out
Investor Participation	Investors had to file lawsuits individually, resulting in high costs and uncertain outcomes	Investor protection institutions can represent more than 50 investors collectively, ensuring automatic inclusion of eligible investors
Investor Protection Institutions	No dedicated institutions for representing retail investors	Investor protection institutions act as litigation representatives, significantly improving efficiency and impact
Litigation Costs	High litigation costs and procedural hurdles limited investors' ability to file lawsuits	Collective litigation mechanisms lower the litigation costs for individual investors
Representative Model	Individuals had to collect evidence themselves and navigate procedural requirements	Representative mechanism addresses procedural issues, leveraging institutional capacity for evidence collection
International Comparison	Lack of alignment with international standards, such as U.S. lawyer-driven class action models	Adoption of U.S Class Action, introducing opt-out mechanisms and broader applicability of collective litigation
Litigation Efficiency & Accessibility	Inefficient and fragmented, leading to prolonged or unresolved cases	Enhanced efficiency and shorter litigation cycles, increasing the scale and impact of collective lawsuits

Figure 3: Table of Comparison between pre and post 2019 Securities Law

Other than private enforcement, the public enforcement led by CSRC strategically changed after 2019.

The CSRC's regulatory strategy before 2019 heavily depended on administrative actions to ensure compliance and maintain market order. Articles 170 and 179 of the Securities Law (2019) empowered the CSRC to investigate and punish a wide range of violations, including fraudulent disclosures, insider trading, and market manipulation. The CSRC's "centralised and decentralised enforcement structure" played a crucial role in optimising regulatory efficiency before 2019. While the central office handled significant national-level cases, regional offices were delegated authority to address local violations. The number of administrative cases increased significantly as a result of this 2013 reform, which improved local offices' enforcement capacity. Although the administrative actions were successful in enforcing market discipline, they had disadvantages. For instance, despite quickly fixing violations, it did not directly compensate investors for losses. This discrepancy demonstrated the need for a more comprehensive regulatory framework to protect investors.

In contrast, the 2019 revision of the securities law marked a turning point in the CSRC's regulatory strategy. Recognising the limitations of relying solely on administrative actions, the revised framework introduced mechanisms to provide direct and indirect compensation to investors.

One of the most significant innovations introduced post-2019 is the advance civil compensation mechanism. Article 93 of the Securities Law (2019) mandates that responsible parties—such as controlling shareholders, actual controllers, and relevant securities firms—compensate investors for losses. This compensation is provided before the conclusion of legal or administrative proceedings, ensuring timely relief for harmed investors.

The CSRC's dedication to investor protection is further demonstrated by the implementation of mandatory mediation. The Securities Law (2019), Article 94(1), mandates mediation as a means of settling securities disputes. Under this system, the CSISC is also legally obligated to participate in mediation upon an investor's request, while investors retain the option to proceed with litigation if they are dissatisfied with the outcome of mediation.

Similarly, Articles 94(2) and 94(3) of the Securities Law (2019) enhance the role of CSISC in investor protection. The CSISC is authorised to support investors in initiating lawsuits and pursuing derivative litigation on behalf of minority shareholders who are not eligible under the Company Law.

In sum, before 2019, the CSRC's regulatory approach was primarily deterrence-based, which focused on penalising violators to maintain market order. The post-2019 reforms introduced a more balanced approach, integrating deterrence with restorative justice mechanisms aimed at protecting investors and promoting fairness. That is, this reform of China's securities enforcement framework highlights a significant transition from an administrative deterrence-centric approach to a balanced system emphasising investor compensation.

However, although compensation has now become a key objective, how this transition of objective is to be understood and achieved is rooted very much within the political and social context for China's capital markets.

Aspect	Pre-2019 Securities Law (Administrative Enforcement)	Post-2019 Securities Law (Comprehensive Enforcement)
Primary Tools	Administrative penalties	Advance compensation, mediation, litigation support
Enforcement Structure	Centralized and decentralized	Decentralized with enhanced investor participation
Investor Focus	Indirect (via deterrence)	Direct (timely compensation and support)
Speed of Relief	Slow (post-investigation and adjudication)	Fast (advance compensation and mediation)
Scope of Protection	Reactive (focused on violations)	Proactive (focused on investor recovery)

Figure 4: The Key Transition from Pre-2019 to Post-2019 Securities Law

4.3.2 Complementarity Analysis from the Socialist System with Chinese Characteristics and Confucianism

The formation and evolution of China's securities law enforcement model have been deeply embedded within the historical and cultural soil of its national governance system.[756] When examining this legal phenomenon through the dual dimensions of institutional choice, the interaction between political-economic logic and cultural genes reveals unique explanatory power. The effectiveness of this analytical framework lies in how these dual dimensions not only shape the institutional architecture of the securities law

[756] Liao Yi, 'On Expounding the Proposition of "Constructing the Independent Legal Knowledge System of China"' (2024) 11 Politics and Law 20, 22.（廖奕：《"建构中国自主法学知识体系"的命题阐释》，载《政治与法律》2024 年第 11 期，第 22 页）

enforcement but also continuously influence the power/right allocation pattern between public and private enforcement in securities matters during dynamic evolution. The framework of pre-2019 securities enforcement has shown that it historically particularly prioritises public legal enforcement. That is, from the perspective of political economy, China's legislative process regarding securities markets emphasises regulatory oversight as the primary engine of economy.

The line between the market and the government maintains a dynamic balance that is tense within the framework of a socialist market economy with Chinese characteristics.[757] The uniqueness of this equilibrium is still inherited by Article 7 of the Securities Law (2019), which translates the principle of "Party leadership over finance" into concrete institutional arrangements.[758] Within this principle, China's vertical configuration of regulatory power—the "dual control system combining vertical hierarchy (tiao) and horizontal jurisdiction (kuai)" formed by local regulatory branches and the central securities regulatory department (CSRC)—essentially constitutes an administrative structure with Chinese characteristics (see Section 4.1).[759]

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[757] Feng Lixia, 'Contemporary Significance of Sinicization of Marxist Legal Theory' (2018) 1 Chinese Journal of Law 3, 7.（封丽霞：《马克思主义法律理论中国化的当代意义》，载《法学研究》2018 年第 1 期，第 7 页）

[758] Huang Tao, 'The Rule of Law Connotation of "Party Leadership in Finance"' (2024) 4 SJTU Law Review 62, 68.（黄韬：《"党管金融"的法治内涵》，载《交大法学》2024 年第 4 期，第 68 页）

[759] Qian Dajun and Guo Jinyang, 'Fragmentation Integration and Strip-Block Reconstruction: The Dual Logic of the Rise of Regional Cooperative Legislation' (2023) 12 Hebei Law Science 24.,

Beyond the legal text and administrative structure, the tiao-kuai arrangement has also emerged in practice. A typical example of tiao is the 2015 market rescue intervention by the “national team,” which not only demonstrated the political mobilisation capacity of the public enforcement system but also revealed the underlying governance logic of securities market regulation: when market fluctuations risk evolving into systemic crises, direct administrative intervention assumes institutional primacy.[760] The distinctiveness of kuai mechanism lies in how securities law enforcement inevitably becomes intertwined with local political performance evaluations. Its operational logic manifests through a performance-driven and intra-governmental competition, which incentivises enforcement efficiency while aligning with political priorities.[761]

However, this vertical configuration of power produces a side effect: private litigation mechanisms are often perceived as potential threats to local economic indicators like stability and competitiveness. For instance, local governments remain highly sensitive to social stability risks and the potential loss of competitive advantage for local enterprises caused by delisting. This

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37.（钱大军、郭金阳：《碎片整合与条块重构：区域协同立法兴起的二重逻辑》，载《河北法学》2023 年第 12 期，第 37 页）

[760] Li Shuguang, ‘Legal Reflections on “Stock Market Crashes” and “Market Rescue”’ (2015) 3 China Law Review 201, 204.（李曙光：《关于“股灾”与“救市”的法学思考》，载《中国法律评论》2015 年第 3 期，第 204 页）

[761] Ibid.

sensitivity permeates civil litigation domains through financial judicial policies, creating implicit suppression of private enforcement.[762]

Shifting to cultural analysis, traditional cultural influences shape securities legal institutions through more subtle mechanisms. Specifically, the Confucian ideal of “No Litigation” (wusong) and “Ritual Governance” (lizhi) has undergone modern transformation, evolving into distinctive dispute resolution preferences in securities practice.[763] A typical manifestation emerges when illegal activities occur, sophisticated investors tend to seek remedies through petitioning channels (*xinfang*, citizens submit complaints to designated government offices) rather than through judicial procedures. This behavioural pattern reflects both path dependence on administrative authority and inherent scepticism about judicial effectiveness.[764] Back to institutional design, such cultural psychology translates into a customary approach of “replacing civil liability with administrative penalties” has relegated securities civil compensation systems to auxiliary status.[765]

[762] Eg Li Wei, ‘Understanding and Application of the “Provisions on the Jurisdiction and Acceptance of Litigation Cases Related to the Regulatory Functions of Stock Exchanges”’ (2005) 6 People’s Judicature 22-24.
（李伟：《〈关于对与证券交易所监管职能相关的诉讼案件管辖与受理问题的规定〉的理解与适用》，载《人民司法》2005 年第 6 期，第 22-24 页）

[763] Wei Zhixun, ‘The Historical and Cultural Causes and Institutional Expressions of the Peaceful Characteristics of the Chinese Legal Tradition’ (2024) 5 Journal of Gansu University of Political Science and Law 1-9.（魏治勋：《中华法系和平性特征的历史文化成因与制度表达》，载《甘肃政法大学学报》2024 年第 5 期，第 1-9 页）

[764] Ibid.

[765] Zhu Yu, ‘The Concept and Path of Deepening the Reform of Litigation Source Governance under the New Situation’ (2024) 16 People’s Justice (Application) 4, 6.（朱玉：《新形势下深化诉源治理改革的理念与路径》，载《人民司法（应用）》2024 年第 16 期，第 6 页）

Evidence of this logic can be found in the 2019 *National Court Civil and Commercial Trial Work Conference Guidelines*, which explicitly categorise securities disputes as "key risk cases" requiring special judicial handling mechanisms. The continuity of this risk prevention mentality can be traced to the evidentiary preconditions in judicial interpretations of false statements—The initiation of a civil lawsuit requires an administrative penalty as a prerequisite. Although it was abolished in 2022, these requirements effectively filtered private litigation for 18 years.

To further validate these observations, a normative density analysis of legislative texts corroborates the value orientation underlying institutional design. This study shows that in the Securities Law (2019) text, the term "shall" appears 47 times in clauses concerning CSRC authority, while "may" constitutes over 80% of the expressions in civil compensation provisions. This normative discrepancy is not coincidental but profoundly reflects institutional designers' differentiated positioning of public-private enforcement mechanisms.

Case analysis best reveals deeper this institutional logic. The *Kangmei Pharmaceuticals* case (see Section 3.2), a landmark case in China's securities litigation history, provides an exemplary sample for observing the interaction between "politics and culture" and institutional practice. Case characteristics show that although the CSISC possessed independent litigation standing when the case commenced in 2021, the actual driving force originated from the CSRC's administrative will (see Section 3.1.2).

Accordingly, the essence of this philosophy differs fundamentally from Western models of spontaneous private enforcement, representing instead an administrative-led "precision remedy." The cultural roots of this phenomenon lie in its resonance with China's paternalistic governance tradition: when judicial authorities lack sufficient confidence in market entities' self-regulatory capacity, moderate administrative intervention gains cultural legitimacy.[766] At the institutional design level, this political-cultural logic manifests in stringent control over private enforcement mechanisms.

To sum up, under the combined influence of political economy and cultural values, China's securities legal system has developed a unique complementary relationship between public enforcement (CSRC) and private litigation, where both avenues serve public interest objectives of deterrence and compensation, and are, at a higher level of understanding, publicly ordered. The nature of this complementarity lies in China's unique political-economic model and cultural characteristics. Its institutional efficacy manifests through attempts to balance market stability with social harmony

[766] Liang Fengrong and Yang Kunpeng, 'The Judicial Pursuit and Practice of the County Magistrate in Qing Dynasty' (2016) 2 Northern Legal Studies 145, 147-151.（梁凤荣、杨鲲鹏：《清代州县官的司法追求与躬践》，载《北方法学》2016 年第 2 期，第 147-151 页）

while promoting capital market fairness and efficiency through coordinated public-private enforcement.

5. Conclusion

Over the course of several decades, China's securities market has developed, which has shown notable institutional and regulatory changes. This study examines the historical trajectory, theoretical foundations, enforcement mechanisms, and practical outcomes of securities litigation in China. The analysis provides a comprehensive understanding of key reforms and their implications.

Like other jurisdictions, the efficacy of China's securities market depends on its enforcement frameworks. Among them, private enforcement mechanisms are pivotal, which empowers individual investors to pursue compensation for losses. Specifically, issuers face strict liability, while other entities (non-issuers) are subject to constructive fault liability. Those *mens rea* requirements ultimately allow investors to seek damages without the arduous burden of proof. Complementing these causes of action, doctrines such as the fraud-on-the-market theory, the presumption of reliance, further mitigate evidentiary challenges. Taken together, the private enforcement seems like a practical and potent instrument for preserving market integrity.

The introduction of the SRL is an important step in improving investor protection in China, and this system allows many investors to join together in one case, making the process more efficient than traditional group lawsuits. Well-known cases like *Kangmei Pharmaceuticals* show how SRL can help more investors take part, speed up the process, and provide meaningful compensation. However, there are still problems. Courts lack experience, the rules for starting a case are unclear, and the public agency in charge, the CSISC, has few financial incentives. To improve the system, China needs clearer procedures and more support for the agency so that SRL can reach more people and have a bigger impact.

Public enforcement in China is mainly carried out by the CSRC. It works alongside private enforcement by focusing on preventing violations and watching over the whole system. The CSRC uses both central and local offices to investigate and punish those who break the rules. It can give fines, suspend trading, or take away licenses—strong actions that help stop misconduct. In addition to penalties, the Securities Law (2019) also made public enforcement work better in compensation. One example is the advance compensation system. This lets violators compensate harmed investors early, helping reduce financial harm and avoid long court cases.

Despite existing synergies, the combination of publicly-ordered private and public enforcement mechanisms may still face shortfalls in achieving investor protection. For example, the predominant focus on administrative penalties has at times, stifled the advancement of robust private enforcement avenues. This is reflected in the sparse utilisation of the SRL system. Thus, it necessitates fostering stronger dialogue between legislation and regulators, increasing procedural transparency, and introducing incentives to encourage utilisation of private enforcement.

China's experience in securities enforcement offers valuable insights for jurisdictions seeking to balance investor protection with market efficiency. The complementary roles of private and public enforcement can achieve a more integrated approach that leverages the strengths of both mechanisms. China however needs to refine its legal framework and foster collaboration among regulators, courts, and investor protection agencies, to further enhance the effectiveness of its securities litigation system, in order to safeguard investors' rights and contribute to a transparent, equitable, and resilient capital market.

Chapter V

Comparative Institutional Complementarity Analysis: Insights from the U.S., U.K., and China

1. Cross-National Variations in Securities Investor Protection: Legal Rules, Collective Action, and Regulatory Intervention

This Chapter firstly offers a comparative analysis of securities enforcement mechanisms across the U.S., U.K., and China. It provides a systematic overview, divided into three key sub-Sections. Section 1.1 and 1.2 focus on private enforcement, examining causes of action and collective procedures, while Section 1.3 addresses public enforcement, highlighting the role of regulators. These three parts synthesise the findings from the previous parts, drawing attention to the similarities and differences between private and public enforcement mechanisms in the three countries. Through this comparison, it illustrates how enforcement approaches vary by jurisdiction, with particular emphasis on the balance with private litigation. This comparison also ultimately argues that differences in the nature of private securities enforcement in each jurisdiction must be understood within the institutional complementarities framework. While this does not mean that they do not need improvement or reform, reform based on seeking an objective optimality may be misplaced, particularly in relation to copying from perceived successful capital markets.

1.1 Comparison of Legal Basis and Investor Protection Liability Standards

In the U.S., securities liability diverges between the Securities Act of 1933 and the Securities Exchange Act of 1934. Under the Securities Act, Section 11 imposes strict liability on issuers for material misstatements in registration statements, requiring no proof of *mens rea* (strict liability) or reliance (*Omnicare, Inc. v. Laborers*). Non-issuers (e.g. underwriters, auditors, etc.) may avoid liability via a "due diligence" defence, which requires demonstrating that they conducted a reasonable and thorough investigation (*Escott v. BarChris*). Section 12(a)(2) permits investors to claim rescission or damages (if the investor has sold it) for prospectus misrepresentation but mandates privity during the transaction (*Gustafson v. Alloyd*), with a "reasonable care" defence for defendants. Under the Exchange Act, Rule 10b-5 allows a presumption of reliance via the fraud-on-the-market theory (*Basic Inc. v. Levinson*) but requires proof of scienter (*Ernst & Ernst v. Hochfelder*). Section 14 applies negligence standards to proxy/tender misrepresentation

(*Gould v. American Hawaiian*). Similarly, there are presumptions of reliance that ease plaintiffs' burden of proof (*Mills v. Electric Auto-Lite*).

In the U.K., liability frameworks blend statutory regimes under the FSMA 2000 and common law principles. The tort of negligent misstatement (*Hedley Byrne v. Heller*) attempts to establish a proximate relationship between parties, and courts often look closely at whether misstatements directly influenced investment decisions to recognise the causation (*JEB Fasteners*). The Caparo test (*Caparo Industries plc v. Dickman*) and Possfund (*Possfund Custodian Trustee*) delineate the duty of care in common law, establishing a doctrinal framework (foreseeability, proximity, fairness etc.) that enables claimants to recover financial losses tied to negligent misrepresentations in securities market. Notably, these cases help define the doctrinal boundaries of Section 90 FSMA 2000 while creating an alternative legal pathway for claimants to pursue underwriters in contexts where Section 90 FSMA 2000 itself is inapplicable. Under Section 90 FSMA 2000, defendants face near-strict liability for prospectus misrepresentations, with claimants needing only to show loss causation, not reliance (*The RBS Rights Issue Litigation*). This contrasts with Section 90A FSMA 2000, which targets issuers' fraudulent or reckless misstatements in continuous disclosure, requiring the burden to claimants to prove the *mens rea* and reasonable reliance (*ACL Netherlands BV v. Lynch*). Here, the tort of deceit (*Derry v. Peek*) supplements the breadth limitation under Section 90A FSMA 2000 by allowing claimants to demonstrate that besides the issuer, other defendants would be liable if they intentionally or recklessly made misstatements that directly caused reliance through a subjective honest test (*Akerhielm v. De Mare*).

China's Securities Law (2019) adopts a unitary liability framework where the liability is merely differentiated based on the roles of parties responsible. Issuers face strict liability under Article 85 for disclosure violations; investors need only prove a causal link between misrepresentation and losses, eliminating the need to demonstrate *mens rea* and reliance. Under Article 85 (the latter part of the provision) and Article 163, non-issuers (e.g. directors, underwriters, auditors, controlling shareholders, etc.) are subject to constructive fault, requiring no burden of proof of *mens rea*, but defence provided. Directors, for instance, must prove "duties associated with a particular position" in oversight, while underwriters and experts are liable only for documents they endorse, assessed against professional standards. A notable innovation is China's fraud-on-the market theory in judicial interpretation, which presumes that public misrepresentations automatically distort market prices, theoretically easing plaintiffs' burden in proving transactional causation—akin to the U.S. model. This "unitary" model prioritises investor protection by lowering evidentiary hurdles, fostering market transparency subject to no, or at most a reserved, burden of proof regarding *mens rea* in both primary and secondary market contexts.

1.2 Collective Litigation Mechanisms and Efficiency of Investor Redress

In the U.S., class actions under FRCP 23 enable groups with shared legal claims to sue collectively, enhancing judicial efficiency. Certification requires plaintiffs to meet Rule 23(a) criteria: Numerosity, Commonality (shared legal/factual issues), Typicality (alignment between lead and class claims), and Adequacy of Representation (no conflicts of interest). Rule 23(b)(3) further mandates Predominance (common issues outweigh individual ones) and Superiority (class action as the fairest method). It uses an opt-out system, meaning all members are included unless they choose to leave. This is different from opt-in systems, where members must sign up. The opt-out system helps include more people and gives the group stronger bargaining power, while it is constrained by a “best notice” rule, which helps protect the rights of individuals. U.S. securities class actions further thrive due to the fraud-on-the-market theory because it is the key foundation easing certification in Rule 10b-5. Procedural incentives like contingency fees (attorneys paid from winnings) and cost-shifting rules (plaintiffs bear own costs) drive participation, enabling efficient resolution of mass disputes.

The U.K.'s collective litigation landscape faces procedural hurdles. Group Litigation Orders (GLOs) allow opt-in claims with relatively simple requirement of "common or related issues" but are rarely used (≈5 cases annually). Representative Actions (RAs) use an opt-out model, but demand claimants strictly share the "same interest," recently broadened in *Lloyd v Google*. Joint Case Management consolidates claims under strict conditions, as seen in *Reichhold Norway v. Goldman Sachs*. Despite reforms like the 2015 Collective Proceedings Order (CPO)—an opt-out model requiring CAT certification—securities litigation remains excluded. The CPO's focus on claim efficiency over merits, highlighted in *Merricks*, has again yet to apply to securities cases. Barriers include the "Loser Pays" cost rule, deterring claimants due to financial risks, and the lack of contingency fee options. Although third-party funding, limited by liabilities (*Arkin*), offers partial relief, later case presented a counter view on it (*Sharp v Blank*). Together, these challenges constrain collective actions.

China's Securities Law (2019) introduced the SRL, empowering CSISC to represent 50+ investors via an "implied participation, explicit withdrawal" model. This addresses inefficiencies in traditional representative litigation (high costs, low success rates) and binds all investors unless they opt out, as per Article 95 of the Securities Law. The landmark *Kangmei Pharmaceutical* case showed the power of the SRL. It won 2.46 billion yuan in compensation for over 52,000 investors. This shows that the system can help stop securities misrepresentation in the market and improve investor compensation. However, problems remain. The rules for choosing cases are unclear. Furthermore, CSISC is a non-profit group, so it has fewer incentives to take on costly lawsuits. It is also unclear how to convert traditional representative litigation into SRL (certification), which may lead to biased choices. Even so, the system does help prevent frivolous litigation by setting a high bar to file cases, and it also gives CSISC more power to settle/mediate disputes and improve efficiency. While this system is a big step forward, it still needs clearer rules and wider use to better protect investors and keep the market fair.

1.3 Public Enforcement: Regulatory Tools and Systemic Oversight

The U.S. SEC enforces securities laws in two main ways: through administrative proceedings and civil actions. Administrative cases are handled by judges chosen by the SEC, giving the agency more control. For example, in *SEC v. Weatherford International PLC*, the company was fined $140 million for false financial statements. Civil actions are brought in federal courts, where there are jury trials and stronger legal protections. In *SEC v. WorldCom*, the SEC used this route to address accounting fraud. The SEC can use several tools as punishment or to fix harm. These include court orders to stop certain actions (injunctions), financial penalties, and taking back illegal profits (disgorgement). Disgorgement (unjust enrichment) helps restore money to investors via Fair Fund—as seen in *SEC v. Texas Gulf Sulphur Co.* Civil monetary penalties (CMPs), strengthened by the 1990 Remedies Act, are meant to punish violators and often go to the U.S. Treasury, but, with the support of the Fair Fund, it is able to distribute financial penalties to harmed investors (*SEC v. Facebook*). Together, these tools help prevent violations and keep the market fair.

The U.K. FCA uses three types of enforcement: administrative, civil, and criminal. Most cases are handled through administrative actions under the FSMA 2000. These include fines and business restrictions, and the parties involved can challenge the decisions through formal notices. Criminal cases are used for more serious violations, often in partnership with other agencies like the SFO. Sometimes, the FCA uses both administrative/civil and criminal processes at the same time—this is called dual-track enforcement. Civil actions help return money to investors who suffered losses as a result of misconduct. These are shown in FSMA 2000 Sections 382–384, and the practice has been shown in *Tesco*. The FCA also encourages firms to cooperate by offering penalty discounts in administrative settlements if violators voluntarily compensate victims, such as in the *Equifax* and *Lloyds Bank* cases. Overall, the FCA's flexible approach aims to balance punishment, compensation, and quick resolution of misconduct.

China's CSRC, set up in 1992, works to supervise the securities market. It uses administrative actions, mandatory mediation and public-support civil actions to enforce the rules. The process includes investigations, hearings by an independent committee, and sometimes referrals for criminal prosecution. Administrative actions—like fines and market bans—help stop misconduct, but they don't directly pay back harmed investors. Under the tiao-kuai administrative structure, cases are handled according to the place and functional competence of each regional office, which helps expedite enforcement. The Securities Law (2019) introduced an advance compensation system that helps investors get money back more quickly. The CSISC also supports investor rights to initiate litigation and create standing for derivative litigation. These tools work together to strengthen public enforcement, helping to deter violations and ensure fair compensation in China's expanding market.

1.4 Summary

The systemic differences summarised above arise from complementary institutional priorities shaped by each jurisdiction's legal traditions, regulatory objectives, and other factors.

China's emphasis on accessibility in private securities-fraud claims—under Articles 85 and 163 of its Securities Law (2019), which lower the evidentiary burden compared with the U.S. and U.K.—helps offset its still-nascent collective redress mechanisms by empowering individual actions for recovery. In the U.S., high scienter thresholds for Rule 10b-5 are counterbalanced by powerful class-action procedures that allow groups of investors to band together. This approach supports meritorious claims without weakening deterrence, while also improving cost efficiency in litigation and strengthening plaintiffs' bargaining power. Meanwhile, the U.K.'s procedural strictness, though limiting collective participation, reinforces evidentiary rigor and reduces frivolous litigation. This strictness aligns with the U.K.'s policy of balancing economic competitiveness and investor protection, and it is reflected in the U.K.'s emphasis on administratively focused public enforcement.

These divergences highlight how distinct legal infrastructures address different goals and institutional contexts inherent in their respective models. The following Sections will explore the "considerations" that underpin these complementary dynamics to deepen the understanding of securities litigation as a tool for investor protection in different ways, thereby illustrating it is reasonable that no single approach can fit all contexts.

2. The Legislative Foundations of Securities Enforcement: How Political Economy

and Cultural Characteristics Shape Private Securities Enforcement

The design of private enforcement must align with the underlying logic of legislation, which determines the starting point for public and private enforcement, and private enforcement mechanisms should be built on this foundation to ensure coherence and effectiveness.

2.1 The Political-Economic and Cultural Co-Construction of China's Securities Enforcement Paradigm

In Chapter IV, the study has shown that the formation of China's securities law enforcement system is deeply rooted in the country's political economy and cultural traditions. The socialist market economy with Chinese characteristics emphasises strong government oversight and centralised regulation, which is reflected in the legislative foundation of the securities law. The legislative framework prioritises public enforcement through institutions like the CSRC, with a historically weak role for private litigation. Moreover, the cultural backdrop of Confucianism, advocating for harmony and minimising conflict, also shapes the legal framework, influencing a preference for state-mediated solutions over private legal actions. This interplay between political, economic, and cultural forces underpins the evolution of China's securities litigation framework (Pre-2019 and Post 2019).

The construction of China's securities enforcement system is far from a mere product of legal-technical transplantation; it is fundamentally an institutional drama directed by the interplay of political-economic logic and cultural traditions. The fusion between the institutional core of a socialist market economy and Confucian governance philosophy has shaped a unique framework dominated by public authority with private rights remedies as supplementary. This framework not only reflects the logic of risk control in capital markets under the national governance system but also reveals the tenacity of indigenous institutional DNA during legal transplantation.

2.1.1 Political-Economic Institutional Anchoring: The Regulatory Paradigm of State Capitalism

The public law orientation of Chinese securities enforcement is rooted in the political-economic paradigm in the 1954 Constitution.[767] Characterised by "market instrumentalization," this paradigm treats capital markets as policy tools for achieving national strategic objectives rather than arenas for pure free competition. According to Witt and Redding's "Coordinated Market Economy" theory,[768] China exemplifies a "politically coordinated" market

[767] Lin Yan, 'The 1954 Constitution as a Model for Constitution-making' (2024) 6 Local Legislation Research 129, 140.（林彦：《作为制宪典范的 1954 年宪法》，载《地方立法研究》2024 年第 6 期，第 140 页）

[768] Michael A. Witt and Gordon Redding, 'Asian Business Systems: Institutional Comparison, Clusters and Implications for Varieties of Capitalism and Business Systems Theory' (2013) 11 Socio-Economic Review 265-300.

system where the government establishes rigid boundaries for market behaviour through legislative power and implements "embedded regulation" via administrative agencies like the CSRC.

Although the Securities Law (2019) introduced SRL, it preserved the foundational logic of public authority primacy. Legislators reinforced this paradigm through a three-tier institutional design: Firstly, the legislation grants quasi-judicial powers to the CSRC, which enables unilateral enforcement measures such as market bans and substantial fines. Second, establishing administrative preconditions for litigation creates a tiered dispute resolution mechanism of "administrative adjudication-judicial review" (it has been abolished in judicial interpretation in 2022). Thirdly, judicial interpretations of core areas like false disclosure to preserve administrative discretion retain ambiguity. This "legislative empowerment-procedural control-interpretative flexibility" triad essentially publicises private law matters, ensuring the state's regulatory authority as the "ultimate risk bearer."

The deeper institutional logic stems from the "developmental state" governance philosophy. Drawing from Johnson's classic study on East Asian governments' "strategic industry intervention" approach, [769] China's securities legislation integrates capital markets into industrial policy

[769] Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975* (Stanford University Press 1982) 305.

implementation by concentrating enforcement powers. The CSRC thus functions not merely as a market regulator but also as an indirect resource allocator. For instance, the CSRC retains the authority to conduct substantive reviews of IPO applications, imposing stringent eligibility thresholds for issuers. Although China's registration-based IPO reform is currently transitioning toward a system that confines the CSRC's role to "information disclosure oversight and industrial policy compliance," the regulator's proactive framework ultimately reflects legislators' instrumentalist perception of market functions.[770]

2.1.2 Cultural DNA: Confucian Governance Philosophy

Confucian traditions shape securities law enforcement not merely by fostering an aversion to litigation, but by embedding deeper value hierarchies and institutional logics into the legal system. The historical synthesis of Confucian and Legalist thought emphasises ritual over rules and virtue over punishment, which continues to influence enforcement through three distinct institutional patterns.[771]

[770] CSRC, 'Full Implementation of Registration-Based Stock Issuance System Rules' http://www.csrc.gov.cn accessed 3 April 2025.（中国证监会：《全面实行股票发行注册制制度规则发布实施》，载中国证监会官网<http://www.csrc.gov.cn> accessed 3 April 2025）

[771] Luke T Lee and Whalen W Lai, 'The Chinese Conceptions of Law: Confucian, Legalist, and Buddhist' (1977) 29 Hastings LJ 1307, 1308.

Firstly, the "differential trust" structure suppresses private enforcement. Confucian culture of "particularistic trust" emphasising moral constraints in close-knit communities' conflicts with capital markets' need for "universalistic trust."[772] Legislators thus rely on administrative "paternalistic regulation" to compensate for deficient social trust capital. As we have seen, Article 171 of the Securities Law (2019) exemplifies this by granting the CSRC broad authority to intervene in corporate governance, positioning regulators as "quasi-parental" figures.

Second, the "harmonious order" concept reshapes liability allocation.[773] Confucian "dispute minimisation" ideals embed through two mechanisms: (1) Procedure barriers to collective action, such as high thresholds for civil lawsuits; (2) Progressive dispute resolution channels ("administrative mediation-hearings-reconsideration") diverting conflicts from judicial processes.[774] Consequently, private legal enforcement's function under the Securities Law, especially before 2019, primarily serves symbolic deterrence.

[772] Wong Siu-Lun, 'Chinese Entrepreneurs and Business Trust' in Gary G Hamilton (ed), *Asian Business Networks* (Routledge 1996) 13.

[773] Lin Jia, 'Improving the Social Law System in the Context of Chinese Modernisation' (2025) 1 China Legal Science 50, 53.（林嘉：《中国式现代化背景下社会法体系的完善》，载《中国法学》2025 年第 1 期，第 53 页）

[774] See Chapter IV Section 2 and Section 4.

Thirdly, "moralised regulation" influences enforcement styles.[775] The Confucian "meritocratic governance" tradition fosters assumptions about regulators' moral authority, evident in two aspects: (1) Legislative authorisation of informal regulatory tools (window guidance, moral suasion); (2) Frequent use of moralised legal elements like "disrupting market order" or "violating social morality" in judicial interpretations. This moralisation tendency endows securities enforcement with dual functions of normative coercion and ethical edification.[776]

2.1.3 Theoretical Implications

The evolution of institutions is shaped not by the static coexistence of political, economic, and cultural elements, but by their continuous and dynamic interplay. As Douglass North argues, it is the tension and interaction between formal rules and informal norms that chart the course of institutional development.[777] In the case of China, the distinct character of its securities enforcement has been forged through precisely such a historical entanglement.

[775] Gao Quanxi, 'The Virtue Dimension of the Rule of Law: Beginning with a Conversation by Hu Shi' (2016) 1 China Law Review 24-28.（高全喜：《法治的德性之维——从胡适的一番言谈说起》，载《中国法律评论》2016 年第 1 期，第 24-28 页）

[776] Wang Lijun, 'The Historical Origin of the Judicial Reform Theory in Xi Jinping Thought on the Rule of Law' (2023) 5 Political Science and Law Review 3, 6.（王利军：《习近平法治思想中司法改革理论的历史渊源》，载《政法论丛》2023 年第 5 期，第 6 页）

[777] Douglass C North, *Institutions, Institutional Change and Economic Performance* (Cambridge University Press 1990) 36.

Temporally, the 1998 consolidation (upgraded to ministerial status) of CSRC authority marked a shift from planned economy "departmental fragmentation" to "state capacity building." This transition, coinciding with SOE reforms' capital market demands, forced securities legislation to balance marketisation imperatives with state control retention.[778] As for the 2019 revision of Securities Law, "Chinese-style class action" introduction still shows that China carefully alleviates institutional tensions through procedural refinement (SRL) rather than structural revolution.

Spatially, the global regulatory "enforcement pyramid" undergoes an indigenous paradigm in China.[779] While a theoretically optimal regulation should gradually progress through "self-regulation → administrative oversight → judicial recourse," Chinese practice maintains administrative regulation at the beginning, with self-regulation （自律管理） and judicial remedies under its radiating control. This modification originates from the political system's institutional architecture（顶层设计）—the Party's comprehensive leadership requiring centralised risk control in critical sectors, manifested in the CSRC's "super-regulator" status.[780]

[778] Eg Xing Huiqiang, 'Three Institutional Conditions of Successful Implementation of Stock Offering Registration System' (2016) 5 Finance and Economics Law Review 5, 9-10.（邢会强：《股票发行注册制成功实施的三个体制机制条件》，载《财经法学》2016 年第 5 期，第 9-10 页）

[779] John Braithwaite, *Restorative Justice and Responsive Regulation* (Oxford University Press 2002) 20.

[780] Wen Changqing, 'Legislative Model and Systematic Construction of China's Financial Stability System' (2024) 4 Legal and Commercial Studies 22, 24.（温长庆：《我国金融稳定制度的立法模式与体系化建构》，载《法商研究》2024 年第 4 期，第 24 页）

China's experience reveals securities enforcement institutions as governance technologies co-created by specific political-economic structures and socio-cultural DNA. Its legislative logic aligns more closely with state functionalism within its indigenous cultural context. Here, legal rules primarily serve national governance objectives (financial stability, industrial upgrading) rather than abstract rights balancing. Moreover, this indigenous form of instrumental rationality gives rise to two characteristics that favour public enforcement: (1) "Principled ambiguity" in legal texts makes policy flexibility; (2) "Re-centralisation" of enforcement power through expanded administrative discretion addresses market complexity.

In sum, China's politico-cultural matrix establishes the foundational trajectory for legal institutional evolution: Anchored in the dialectical interplay between cultural governance and political structuring. When enduring cultural paradigms emphasising hierarchical moral authority （儒家贤能政治传统） synergise with contemporary political imperatives of centralised coordination （党和国家集中统一领导）, the resultant legal evolution manifests as a self-reinforcing process that institutionally ensures public authority's pivotal role.

2.2 The Role of Political Economy and Cultural Characteristics in Shaping U.S. Legislation

The U.S.' legislative approach to securities regulation is anchored in a political economy ideology rooted in liberal market capitalism, which prioritises free enterprise, decentralised governance, and private enforcement mechanisms. Unlike China's state-centric model, the U.S. system emerged from a historical aversion to centralised authority, shaped by Enlightenment ideals of individualism, property rights, and limited government intervention.[781]

2.2.1 Political Economy: Liberal Capitalism and Regulatory Hybridity

The foundational philosophy of the U.S. political economy emphasises market self-regulation, but it is also mildly tempered by targeted public oversight to correct market failures. This dualistic compromise reflects the Jeffersonian distrust of concentrated power and the Hamiltonian recognition of systemic risks in unregulated markets.[782] Accordingly, U.S. legislative practice has long sought to balance laissez-faire ideals with measured regulatory intervention—a pattern most clearly illustrated by the New Deal reforms in the aftermath of the Great Depression.[783] In the meantime, key

[781] Steven Lukes, 'The Meanings of "Individualism"' (1971) 32 Journal of the History of Ideas 45, 59.

[782] Paul Nejelski, 'The Jeffersonian-Hamiltonian Duality: A Framework for Understanding Reforms in the Administration of Justice' (1980) 64 Judicature 450-462.

[783] Eg Laura Kalman, 'Law, Politics, and the New Deal(s)' (1999) 108 The Yale Law Journal 2165, 2191.

statutes like the Securities Act of 1933 and the Securities Exchange Act of 1934 were born out of economic crises that exposed market vulnerabilities of deregulation, yet their design still preserved private litigation as a cornerstone of enforcement to a large extent.

This U.S. framework rests on a belief that market efficiency and investor confidence depend not only on public agencies like the SEC but also on empowering private actors to hold corporations/personals accountable. Thus, the design of the entire securities enforcement framework is consistently built around principles of transparency, mandatory disclosure, and competition. Within this framework, public and private enforcement complement each other, working together to uphold the principles above. It should be noted that, however, within the framework, private rights of action (private enforcement) play an essential role. This decentralised nature of adjudication reflects a deeper societal commitment of individualism and economic democracy, positioning the citizenry as a key participant in upholding the integrity of the market.[784]

The theoretical underpinning of this system is derived from neoclassical economic thought, which posits that markets are generally self-correcting but can sometimes fail due to information asymmetries, externalities, or

[784] Albert B Wolfe, 'Individualism and Democracy' (1923) 33 The International Journal of Ethics 398, 406.

monopolistic practices.[785] In response, the U.S. government intervenes not by replacing market-driven self-correcting mechanisms but by setting functional rules that mildly guide behaviour and protect stakeholders. Thus, compared to its private enforcement, this approach reflects a reactive regulatory philosophy that sees regulation as an auxiliary tool to enable market forces rather than as a primary engine to control them directly.

By contrast, China has pursued a distinct model of political economy. Since the late 1970s, when *DENG Xiaoping* initiated economic liberalisation, the Chinese state has maintained a central role in shaping both national and local economic activity, even as it has gradually introduced market mechanisms across a range of sectors.[786] Here, the Chinese model emphasises the importance of central planning and SOEs, which are seen as key drivers of national development and technological advancement. In this system, regulatory oversight is not only about correcting market failures but also about guiding the economy according to long-term strategic goals set by the government.[787] In detail, the Chinese government or its SOEs maintain tight

[785] James Tobin, 'Neoclassical Theory in America: JB Clark and Fisher' (1985) 75 The American Economic Review 28-29.

[786] Li Xiliang, 'Is Limited Government the Optimal Solution for China's Market Economy?—From the Perspective of Economic Law' (2024) 1 Research on Economic Law 82, 83. （李希梁：《有限政府是中国市场经济的最优解吗？——以经济法为视角》，载《经济法研究》2024 年第 1 期，第 83 页）

[787] Eg Han Ci, 'The Evolution of the Arrangement for Regional Economic Development Since the Reform and Opening-Up: From the Perspective of the Five-Year Plan' (2008) 10 Journal of Kunming University of Science and Technology (Social Sciences) 39-43. （韩慈：《改革开放以来我国区域经济发展布局的演变——以〈五年计划〉为视角》，载《昆明理工大学学报（社会科学版）》2008 年第 10 期，第 39-43 页）

control over key industries, such as finance, energy, and telecommunications.[788] This approach, as we have discussed in Chapter IV, is underpinned by the belief that state or its "national team" can respond to periodic economic fluctuations more swiftly and decisively than market forces alone, both in terms of timing and scale. This capacity not only helps stabilise the economy but also ensures that the country's development path remains clearly aligned with long-term social and political objectives, such as those articulated in five-year plans.

Moreover, while U.S. regulatory practices rely heavily on market-based self-correcting mechanisms such as private litigation, China's approach places greater emphasis on macroeconomic stability and collective welfare. By focusing on systemic resilience, Chinese regulators aim to indirectly safeguard individual well-being on a broader scale. In this context, regulatory intervention extends beyond reactive economic management and requires proactive legislative and enforcement frameworks. Ultimately, this reflects a deeper ideological commitment to collective welfare and state sovereignty, in

[788] Eg Chen Yunliang, 'State Regulation in Extraordinary Times: A Legal Record of China's Economic Governance in 2009' (2010) 6 Rule of Law Studies 15, 18. （陈云良：《非常时期的国家调节——2009 年中国经济法治纪实》，载《法治研究》2010 年第 6 期，第 18 页）

which economic regulation is viewed as an integral responsibility of the government to maintain national cohesion and long-term development.[789]

In summary, shaped by divergent political and historical values, the U.S. securities enforcement framework reflects a hybrid model that emphasises market efficiency and individual accountability. In contrast, China's approach combines state oversight with market mechanisms to advance broader developmental objectives, reinforcing the role of public enforcement in securities regulation. While both systems have their respective strengths and limitations—the U.S. model encourages innovation and protects individual rights but grapples with challenges such as frivolous litigation, regulatory capture, and the politicisation of oversight through electoral processes; the Chinese model prioritises strategic coherence and macroeconomic stability, often at the expense of market autonomy and spontaneous dynamism. This comparative analysis is not intended to judge which model is superior, but rather to underscore how differing political contexts fundamentally shape regulatory philosophies and economic governance.

2.2.2 Cultural Foundations: Adversarial Legalism and Rights Consciousness

[789] Xiao Jing, 'The Logical Basis and Practical Path of Enacting Financial Law' (2025) 2 Journal of Finance and Economics Law 60, 75.（肖京：《制定金融法的逻辑依据与实践进路》，载《财经法学》2025 年第 2 期，第 75 页）

The U.S. cultural traits—particularly adversarial legalism, rights consciousness, and a scepticism of authority—profoundly shape the legislative foundations of securities regulation.[790] These characteristics are deeply embedded in the nation's historical evolution and legal traditions, influencing not only how laws are formulated but also how they are enforced. The U.S. legal system, with its roots in its revolutionary heritage, has long favoured litigation as the primary means of dispute resolution. This adversarial approach is seen in the way securities regulation emphasises judicial remedies over purely administrative actions, ensuring that due process and procedural fairness are central to the legal framework.[791]

At the heart of this system is the cultural valorisation of individual rights and responsibilities. The notion of the "self-made individual" is a powerful narrative in the U.S., encouraging private citizens and entities to step forward as "private attorneys general."[792] This phenomenon, which is relatively unique to the U.S., is evident in the widespread use of shareholder activism and class actions, where dispersed investors collectively challenge corporate misconduct. Accordingly, such mechanisms in the securities market not only

[790] Robert A. Kagan, 'Adversarial Legalism and American Government' (1991) 10 Journal of Policy Analysis and Management 369-406.

[791] Eg Hans A. Linde, 'Due Process of Lawmaking' (1975) 55 Nebraska Law Review 197, 225.

[792] William B. Rubenstein, 'On What a Private Attorney General Is—And Why It Matters' (2004) 57 Vanderbilt Law Review 2129, 2142-2158.

serve to protect individual rights but also function as a deterrent against securities misconduct.

The U.S. legal system reflects a cultural foundation that affirms the legitimacy of using litigation as a tool to assert one's rights and remedy. Rooted in a religious and moral tradition that emphasises personal accountability (particularly the Puritan ethic of moral rectitude),[793] the system views legal action not as a nuisance but as a necessary means of upholding justice. This litigious orientation is further reinforced by a well-developed tort law framework. Within the framework, misrepresentation is met with stringent legal consequences, which shows institutionalising moral responsibility through the legal process.

The focus on private enforcement through lawsuits shows a strong belief in individual rights in American society. Americans have come to view that laws are not just for protecting themselves, but also for holding powerful groups responsible for their misconduct.[794] Thus, this belief further grants individuals the confidence and capacity to take legal action to protect their rights, and it thereby helps individuals oversee the behaviour of companies and other large institutions. In the end, the strong trust in judicial branch—

[793] Roscoe Pound, 'Puritanism and the Common Law' (1911) 45 American Law Review 811-829.

[794] Mark E Warren, 'Civil Society and Good Governance' (1999) Paper for the US Civil Society Project, Georgetown University, Washington <https://citeseerx.ist.psu.edu/document?repid=rep1&type=pdf&doi=12ba648ea8bb7143180c26cb46d2d16d447c9eec> accessed 23 May 2025.

rather than in administrative intervention—shows a deep mistrust of centralised authority. This mistrust goes back to America's fight for independence from what was seen as unfair rule.

Unlike the U.S. system, China's legal system is shaped by Confucian values that focus on keeping social harmony and group stability, rather than encouraging individual conflict. This is especially seen in China's strong use of mediation. Instead of solving problems through adversarial court battles, the goal is to reach agreement and avoid open fights or dissatisfaction. As a result, many disputes in China are handled through government or administrative processes, rather than through confrontational court cases.

Moreover, while the U.S. legal system encourages individuals to seek remedies through the courts,[795] China's regulatory model reflects a more collectivist approach. It reflects a deep-rooted cultural tradition that prioritises the interests of the family or community over personal interest. Thus, in the Chinese context, legal enforcement is often viewed primarily as a tool for maintaining social stability, rather than as means for individuals to challenge authority. As a result, mechanisms like shareholder activism and class actions, which are common in the U.S., remain relatively rare in China. Instead, the

[795] Deborah G Martin, Susan Hanson and Danielle Fontaine, 'What Counts as Activism? The Role of Individuals in Creating Change' (2007) 35(3/4) Women's Studies Quarterly 78, 83.

state's intervention plays a more active and direct role in identifying and correcting market misconduct.

Additionally, the U.S. cultural predisposition towards scepticism of authority has led to a legal framework that is inherently decentralised, relying on a network of courts, private litigants, and regulatory agencies to mildly monitor and enforce securities laws. [796] In contrast, Chinese securities regulation is characterised by a top-down approach, where regulatory intervention proactively operates under the direct management of the state. This centralised oversight allows for comprehensive, targeted management of market crises, but it may also limit space for independent judicial review and private legal enforcement.

In summary, the U.S. securities enforcement framework is deeply rooted in cultural values that embrace litigation, individual rights protection, and scepticism toward centralised authority. It not only prioritises procedural fairness such as due process but also empowers private citizens to proactively help enforce laws. In contrast, China's legal system, shaped by Confucian ideals, emphasises administrative resolution and state-led intervention, prioritising social harmony and collective well-being. These different cultural foundations show how historical traditions and societal values fundamentally

[796] Joseph Gershtenson and Dennis L Plane, 'In Government We Distrust: Citizen Skepticism and Democracy in the United States' (2015) 13(3) The Forum (De Gruyter) 481, 484-487.

influence legal regulation, leading to two distinct ways of managing securities markets.

2.2.3 Political Economy and Cultural Dynamics Shaping Securities Enforcement Legislation in the U.S.

The combination of U.S.'s liberal market political economic context and adversarial cultural norms has shaped a securities enforcement system that is highly decentralised, litigation-heavy, and focused on empowering investors.

Politically, the preference for limited state intervention aligns with a cultural distrust of centralised authority, and together they create a system where public agencies like the SEC share enforcement responsibilities with private enforcement. For example, the SEC's role centres on overseeing the overall system and making related ancillary rules. Meanwhile, laws such as Section 11 of the Securities Act and Rule 10b-5 under the Exchange Act provide strong legal grounds of causes of action and give private parties significant authority to enforce them. Culturally, the emphasis on individual rights to confront authority justifies mechanisms such as class actions, which democratise access to justice by aggregating small claims into powerful lawsuits. In sum, this dual enforcement structure—where public agencies play a supporting role and private actors take the lead—reflects a system shaped by compromise between citizen and authority where markets are allowed to operate freely, but accountability is enforced through a mix of regulatory scrutiny and private litigation.

Specifically, the creation of the SEC shows how political and cultural values came together to respond to major market failures. Before that, the Great Depression had revealed the dangers of a completely unregulated market, prompting the government to take a more hands-on but cautious role.[797] Still, this shift was not a full move toward state control. The SEC's formation was more of a practical adjustment: it allowed the government to oversee the market without replacing private legal action.

Politically, the New Deal aimed to rebuild public trust in the markets without upsetting business leaders who held significant political influence. Thus, the legislation created a system where the SEC aimed to work alongside private lawsuits, not instead of them. Culturally, the SEC was built to reflect values like fairness, professionalism, and trust in due process.[798] Its use of administrative judges and legal procedures showed this commitment. But since the agency didn't have unlimited power or resources,[799] and because Americans tend to favour private solutions, individual lawsuits and class

[797] Eg Kris James Mitchener, 'Bank Supervision, Regulation, and Instability During the Great Depression' (2005) 65 The Journal of Economic History 152, 153.

[798] James J. Park, 'Rules, Principles, and the Competition to Enforce the Securities Law' (2012) 100 California Law Review 115, 162-170.

[799] James D. Cox, Randall S. Thomas & Dana Kiku (2003), note 338, 757.

actions remained essential. In the end, this mix allowed the SEC to serve as a market referee—strong enough to keep order, but not so strong as to seem like it was taking over. It struck a balance between the practical need for federal oversight (in the spirit of Hamilton) and the deep-rooted distrust of centralised power (in the spirit of Jefferson).

Moreover, beyond the creation of the SEC, the key legal tools available for enforcement. For example, the strict liability provision in Section 11 of the Securities Act of 1933 and scienter liability under Rule 10b-5 of the Exchange Act of 1934 reflect the deeper interaction between political-economic priorities and cultural values.

Section 11 places strict liability on issuers for any material misstatements in registration statements, which reflects a political choice to favour investor protection over corporate convenience in private enforcement. It also represents a cultural shift away from the traditional "buyer beware" approach[800] because it places the burden on more powerful corporate actors. Rule 10b-5, on the other hand, was developed through court decisions that broadened the right of private individuals to sue. This development reveals both political support and cultural acceptance of litigation as a legitimate route to justice. While the rule empowers both the SEC and private plaintiffs

[800] John Kiggundu, 'The Fraudulent Vendor of Shares: Buyer Beware' (1993) 110 South African Law Journal 681-685.

to target securities misconducts, in practice those causes of action have become the most widely used and flexible legal tool in securities private enforcement. This embodies the American belief that safeguarding market integrity requires active participation from all investors—not just government regulators.

Finally, the widespread use of securities class actions in the U.S. reflects the country's broader political-economic system and cultural values.

Politically, class actions fit with the liberal market ideal of decentralised enforcement since it aims to allow a large scale of individuals to play a central role in holding accountability, a manifestation of democratic principles. As we have discussed in Chapter II Section 4.3, this litigious tool operates more effectively than resource-limited regulators. Culturally, these lawsuits reflect strong traditions of individualism and rights consciousness. By using collective legal procedures, class actions bring together the rights of many individuals to stand up to powerful entities. Key procedural tools—like the opt-out mechanism and contingency fee arrangements—do more than just pool claims together.[801] They make it much easier for small investors to participate, reducing financial and legal barriers. These features are not just legal technicalities, but they show a broader social commitment to equal

[801] See Chapter II Section 3.2 and 3.3.

access to justice. In this environment, litigation is not seen as a burden on the system, but as a vital mechanism for correcting securities misconduct. The result is a legal culture that reinforces the idea that healthy markets need both public oversight and active private enforcement.

In conclusion, the U.S. securities institutions are fundamentally shaped by its political economy of liberal capitalism and cultural traits of adversarial legalism and individualism. These forces establish a legislative logic that prioritises private enforcement (decentralised adjudication). Here, causes of action like Section 11 and Rule 10b-5, alongside the ubiquity of class actions, reflect a systemic belief that market integrity depends on empowering individuals to hold violators accountable.

2.3 The Role of Political Economy and Cultural Characteristics in Shaping U.K. Legislation

The U.K.'s legislative methodology in securities institutions is also deeply influenced by its political economic ideology (pragmatic liberalism), which merges free-market principles with selective state intervention to balance market efficiency and systemic stability.[802]

2.3.1 Political-Economic Underpinnings of Pragmatic Liberalism

[802] Robert Leach, *Political Ideology in Britain* (Bloomsbury Publishing, 2015) 24.

This ideology emerged from Britain's economic transformation—a shift that balanced tradition with innovative market regulation strategies.

Firstly, after the Industrial Revolution, Britain was the cradle of laissez-faire capitalism in the 19th century. It was a period marked by minimal state interference and a near-absolute faith in the market's ability to regulate itself.[803] From the perspective of how to manage the market, the dominant view held that markets would naturally equilibrate supply and demand, producing optimal outcomes when left to function to their own devices. As *Varieties of Capitalism* explains, this era established the foundation of Britain's economic framework—one that would later define it as a Liberal Market Economy (LME). The system relied on flexible labour markets and competition, rather than cooperation, to drive growth and coordination.[804] However, the dramatic social, economic and geopolitical disruptions that accompanying the laissez-faire era eventually sowed the seeds of scepticism about this unbridled approach.[805]

The evolution of Britain's political economy continued as the nation transitioned into the post–World War II era. The aftermath of the war brought about a Keynesian consensus that redefined Britain's economic

[803] Eg Colin J Holmes, 'Laissez-Faire in Theory and Practice: Britain 1800–1875' (1976) 5(3) Journal of European Economic History 671, 681.

[804] Peter A Hall and David Soskice (eds) (2001), note 49, 338.

[805] R M Hartwell, 'Interpretations of the Industrial Revolution in England: A Methodological Inquiry' (1959) 19(2) The Journal of Economic History 229, 240.

philosophy.[806] Unlike the pre-war years, the state assumed a more active role, and it emphasised to promote public welfare and instituting regulatory measures to stabilise the economy. Keynesian economics argued that government intervention was not only necessary during times of crisis but could also ensure more equitable growth and stability.[807] This ideological shift was crystallised in policies that embraced welfare programs, public investments, and a cautious form of market regulation aimed at mitigating the adverse effects of economic cycles. It’s important to note that ideological shifts don’t happen overnight. During this period, despite a more interventionist state, the underlying liberal market principles endured as before. That is, even while the state was crucial in controlling the economy and maintaining social stability, the thought of market-self mechanisms influenced by the historical ideology remained in the institutional framework.

By the 1980s, the British economy underwent another ideological transformation under the influence of Thatcherite neoliberal reforms.[808] These reforms were characterised by a strong push back toward deregulation and privatisation of authority, along with an emphasis on global

[806] Luca Benati, ‘Evolving Post-World War II UK Economic Performance’ (2004) 36 Journal of Money, Credit and Banking 691, 708.

[807] Alan Booth, ‘New Revisionists and the Keynesian Era in British Economic Policy’ (2001) 54(2) The Economic History Review 346-366.

[808] Jamie Peck and Adam Tickell, ‘Conceptualizing Neoliberalism, Thinking Thatcherism’ in Helga Leitner, Jamie Peck and Eric S Sheppard (eds), *Contesting Neoliberalism: Urban Frontiers* (The Guilford Press 2006) 26.

competitiveness. The Thatcherite era sought to dismantle what many perceived as the overbearing reach of the state before, yet it simultaneously had to retain key mechanisms to address market failures to balance what the reform had changed.[809]

The FSMA 2000 exemplifies this pragmatic approach. Instead of choosing between laissez-faire capitalism and Keynesian-style intervention, it struck a balance between the two. Unlike systems that rely on rigid, prescriptive rules, the FSMA 2000 established a principles-based regulatory framework. While this approach grants institutions such as the FCA and the PRA broad discretion to interpret and enforce standards in a manner that is responsive to contemporary market conditions, the principle of proportionality embedded in the framework means that the discretionary enforcement is only used if it is required to reduce risk.[810] With this approach, a pragmatic ideology has become a key to maintaining London's status as a global financial hub. That is, excessive regulation could risk constraining the market dynamism that continues to attract global capital.

[809] Ron Martin, 'Thatcherism and Britain's Industrial Landscape' in Ron Martin and Bob Rowthorn (eds), *The Geography of De-industrialisation* (Palgrave 1986) ch 8 <https://doi.org/10.1007/978-1-349-18501-6_8> accessed 2 May 2025.

[810] Paul P Craig, 'Proportionality and Judicial Review: A UK Historical Perspective' (Oxford Legal Studies Research Paper No 42/2016, 15 June 2016) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=xxxx> accessed 2 May 2025.

The post-2008 reforms further highlight the U.K.'s commitment to a politically and economically pragmatic approach. These changes were gradual and targeted, rather than radical. For example, the Banking Act 2009 and subsequent rules like ring-fencing retail banks were direct responses to the problems shown by the 2008 crisis. In practice, these reforms aimed to prevent future crises by separating riskier investment activities from essential retail banking services.[811] With this balance, this targeted approach allowed the government to better protect consumers (regulation on banks) and maintain market stability, but all without abandoning the core principles of market liberalism.

Moreover, the U.K.'s post-Brexit regulatory strategy continues this same pragmatic approach to reform.[812] After the Brexit vote, the U.K. added new layers of complexity and innovation to its political economy. Among them, a key focus has been strengthening market competitiveness. It is because that as the U.K. moves away from the EU model, it aims to build a more flexible and globally regulatory system, showing its own competitiveness. However, this shift has not meant rejecting everything from its time under EU Directives. Instead, as we have discussed in Chapter III Section 1.1, the post-

[811] Martin Craig, 'Post-2008 British Industrial Policy and Constructivist Political Economy: New Directions and New Tensions' (2015) 20 New Political Economy 107-125.

[812] Eg Geoffrey Dudley and Andrew Gamble, 'Brexit and UK Policy-making: An Overview' (2023) 30(11) Journal of European Public Policy 2573-2597.

Brexit legal system will still keep large parts of the existing framework to stabilise the market, while the reform prioritises its own market strengths through gradual adjustments.

In short, this history of reform—from laissez-faire capitalism to Keynesian state intervention, to Thatcher-era deregulation—continues in the post-Brexit era. Britain's legislative approach still reflects a careful balance between state intervention and market freedom, a pragmatic approach to rethinking legislative reform.

It should be noted that due to the influence of capitalism, the U.S. and the U.K. share some overlapping ideas in their political and economic thinking. However, owing to different domestic factors, the U.S. has taken a different path. The U.S. regulatory model has traditionally been more rules-based.[813] As we have discussed in Section 2.2, the U.S. model is shaped by a tradition of legal formalism and a strong emphasis on individual rights, and is often enforced through clear statutes and private litigation.[814] The difference could also be seen in how each country accepts codified institutions—something more embedded in the U.S. This comparison shows how each country's history and institutions have led to different regulatory paths.

[813] Eg George J Benston, Michael Bromwich and Alfred Wagenhofer, 'Principles-versus Rules-based Accounting Standards: The FASB's Standard Setting Strategy' (2006) 42(2) Abacus 165-188.

[814] Eg Robert Goedecke, 'Legal Formalism vs. Legal Pragmatism' (1969) 3 J. Value Inquiry 243-257.

In summary, the evolution of Britain's economic governance illustrates a nuanced ideological journey. Influenced by its classification as a Liberal Market Economy, Britain has developed a regulatory framework defined by proportionality, adaptability, and market-friendly pragmatism. Compared to the U.S.'s more rigid, litigation-centred approach, the U.K. system emphasises flexibility and dynamic regulatory discretion, aiming to balance risk mitigation with the preservation of market innovation and global competitiveness.

2.3.2 Cultural Determinants in Legislative Design: The Gentlemanly Capitalist System

British cultural traits—particularly institutional conservatism [815] —profoundly shape the legislative foundations of securities institutions. Rooted in the U.K.'s common law tradition, which values judicial precedent and incremental legal evolution, the regulatory framework prioritises stability and predictability over radical overhauls.[816] This approach is characterised by a measured, evidence-based method of reform that seeks to build on established legal norms rather than disrupt them with sweeping changes. The emphasis on gradual change reflects a broader cultural belief in learning from historical

[815] Robert D. Jessop, 'Civility and Traditionalism in English Political Culture' (1971) 1 British Journal of Political Science 1-2.

[816] Oona A. Hathaway, 'Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System' (2000) 86 Iowa Law Review 601, 622-645.

experience, where reforms are implemented only after careful consideration of their long-term implications.

The cultural legacy of "gentlemanly capitalism," historically associated with the City of London's reliance on informal networks and reputational enforcement, continues to influence modern legislative design.[817] This legacy is steeped in notions of honour, trust, and mutual accountability among market participants, which underpins regulatory practices that favour consensus and voluntary compliance over coercive state intervention. Specifically, British securities institutions tend to place less emphasis on modern, rigid legal rules and greater weight on fostering self-discipline and ethical conduct rooted in the market's own traditions. As a result, disputes are often handled through negotiation, arbitration, or industry-led panels, or resolved through long-term relationships encouraged by institutional investor stewardship—rather than through long, adversarial court battles. This preference for dialogic outworking rather than antagonistic dispute resolution mechanisms reflects a cultural inclination toward discretion and consensus, in contrast with the U.S. model.

It is important to note that while both the U.K. and the U.S. share a common Anglo-Saxon cultural heritage shaped by their colonial past, their

[817] Martin J. Daunton, '"Gentlemanly Capitalism" and British Industry 1820-1914' (1989) 122 Past & Present 119, 125.

distinct historical experiences of colonialism and state formation have produced significant cultural and institutional divergences. The U.S. regulatory system is strongly shaped by a tradition of adversarial legalism. For example, in securities law, the legal framework is designed to empower individual investors to hold powerful corporate actors accountable through class actions and private lawsuits. Over time, it has helped entrench a legal culture that values litigation and assertive rights-claiming. In contrast, the British regulatory tradition, which is less influenced by adversarialism, leans more on regulatory oversight and cooperative dispute resolution. It tends to favour dialogue, mediation, and institutional engagement over litigation.

Furthermore, British institutional conservatism and a deference to tradition are evident in the structure and operation of its regulatory agencies. The British public's historical scepticism of centralised authority—a legacy of long-standing struggles between the Crown and Parliament[818]—manifests in legislative frameworks that decentralise power. Nearly independent agencies like the FCA operate at arm's length from direct government control. It ensures that regulatory decisions are largely insulated from political pressures, but the function of the agency is still accountable to established legal and ethical standards. This balance between autonomy and

[818] Mark Bevir and Rod A. W. Rhodes, 'Decentering Tradition: Interpreting British Government' (2001) 33 Administration & Society 107, 117.

accountability is a hallmark of the U.K.'s regulatory regime, showing stability and continuity are paramount. In contrast, the U.S. system—although it also has independent regulators like the SEC—works in a more political setting. Politics and new legislation often drive policy changes, which can cause sudden shifts in regulation. This may hurt market stability and make long-term planning harder.

In the U.K., the cultural emphasis on "fair play" and transparency is another key driver behind statutory requirements for corporate governance. For example, key institutions such as the U.K. Corporate Governance Code—which embodies the "comply or explain" principle—reflect the belief that companies should maintain high standards of accountability, and in the meantime, companies also have the enough flexibility to adapt their practices to unique circumstances.[819] Further the U.K. Stewardship Code encourages a constructively engaged and long-termist form of engagement between institutional investors and issuers.[820] This philosophy also underpins the U.K.'s preference for recommendations like those in the *Davies Report* and the unusually high standard set for litigation under Section 90A, reinforcing a regulatory culture that values ethical commitment to stakeholders as much

[819] David Seidl, Paul Sanderson and John Roberts, 'Applying the "Comply-or-Explain" Principle: Discursive Legitimacy Tactics with Regard to Codes of Corporate Governance' (2013) 17 Journal of Management & Governance 791, 810-814.

[820] Iris H-Y Chiu, 'Turning Institutional Investors into "Stewards": Exploring the Meaning and Objectives of "Stewardship"' (2013) 66 Current Legal Problems 443, 451-452.

as legal compliance.[821] U.S. corporate governance, on the other hand, is typically more prescriptive, with strict regulations and onerous disclosure requirements meant to safeguard investors. Although this approach ensures a high level of accountability, it may constrain managerial discretion and responsiveness—a trade-off that highlights the deeper cultural differences between the two nations.

Last but not least, the British approach to regulation reflects a strong sense of empirical pragmatism—a commitment to basing reforms on real-world evidence and measured outcomes.[822] As discussed in Section 2.3.1, British legislative reform in both the aftermath of the 2008 financial crisis and post-Brexit has shown that regulatory adjustments that were responsive to market developments without resorting to dramatic, all-or-nothing shifts.

In summary, British cultural traits—marked by a "gentlemanly" resolution, empirical pragmatism, and a deep conservation for tradition—have shaped a regulatory environment that values gradual change, consensus-building, and institutional stability. This stands in sharp contrast to the U.S. approach, which is driven by a culture of adversarial legalism and individual assertiveness in pursuing judicial remedies. Based on cultural distinctions,

[821] See Chapter III Section 2.4.

[822] Eg David Fate Norton, 'The Myth of "British Empiricism"' (1981) 1(4) History of European Ideas 331, 333.

these cultural foundations have led British institutions to place greater emphasis on alternative dispute resolution, decentralised authority, and ethical corporate governance. As a result, the British legal framework tends to be adaptive yet restrained—favouring long-term credibility and market cohesion over swift, litigation-heavy responses to conflict, as commonly seen in the American model.

2.3.3 Political Economy and Cultural Dynamics Shaping Securities Enforcement Legislation in the U.K.

The interaction between Britain's pragmatic liberalism and cultural conservatism has shaped a securities enforcement regime that is principles-based, emphasises collaborative solutions, and avoids substantial disruption to business relationships.

Politically, the U.K.'s emphasis on a liberal market economy aligns with a tradition of pragmatic reform—blending Keynesian interventionism with Thatcherite neoliberalism. This has provided institutional structures that shows a hybrid model where statutory regulation complements industry self-governance.[823] For example, the FCA enforces broad principles such as "integrity" and "consumer protection." Culturally, a strong deference to tradition supports a conservative preference for incremental reform, as

[823] See Chapter III Section 4.1.

evidenced by the phased implementation of EU directives prior to Brexit, which helped maintain regulatory continuity despite broader political changes.

This duality of political economy and culture is clearly reflected in how the U.K. responds to legislative reform. Following the 2008 financial crisis, for instance, measures such as the Banking Act 2009 aimed to balance market stability with systemic safeguards. Rather than pursuing sweeping nationalisations, the government opted for targeted interventions. Similarly, in the post-Brexit period, targeted adjustments to MiFID 2 rules designed to ease compliance burdens while maintaining transparency underscore the political-economic priority of preserving London's status as a globally competitive financial centre.[824]

Back to securities institutions, the creation of the FCA illustrates the convergence of the U.K.'s political-economic priorities and cultural values.

Politically, the FCA emerged in response to the regulatory failures exposed by the 2008 financial crisis. After the crisis, the dissolution of the FSA marked a political and economic shift toward stronger oversight. Yet, the FCA's role kept the U.K.'s typical pragmatism—focusing on preventing harm and ensuring compensation rather than relying only on punishment.[825]

[824] Eddy Wymeersch, 'Third-Country Equivalence and Access to the EU Financial Markets Including in Case of Brexit' (2018) 4 Journal of Financial Regulation 209, 230-234.

[825] See Chapter III Section 4.1.

Here, it is worth comparing this approach to China's strategy as we have discussed in Section 2.1. Further, in the post-Brexit context, the FCA has gained more freedom to adjust regulations to fit the needs of U.K. markets. Nevertheless, its reforms have stayed cautious. The legislation in Chapter III Section 1.1 shows that the reform tries to avoid major changes from existing standards. Ultimately, this reflects the continued goal of keeping London's reputation as a reliable and stable global financial centre.[826]

Culturally, the FCA reflects the British preference for expert-led governance (self-regulation). Its leadership usually includes professionals from the industry and legal field. This openness shows the public's trust in expert knowledge over political appointments.[827] Moreover, its "forward-looking" way of supervising—focusing on early action and reducing risk—fits with British values of balance, prudence, and institutional stability.[828] Finally, the FCA's independence, based on the FSMA 2000, reflects the U.K.'s long-standing dislike of centralised control.[829] This separation helps ensure that regulatory decisions are protected from short-term political influence.

[826] Scott James and Lucia Quaglia, 'Rule Maker or Rule Taker? Brexit, Finance and UK Regulatory Autonomy' (2022) 43 International Political Science Review 390-403.

[827] Eg Trevor Clark et al., 'Agency over Technocracy: How Lawyer Archetypes Infect Regulatory Approaches: The FCA Example' (2021) 24 Legal Ethics 91, 93.

[828] Rosa M. Lastra, 'Defining Forward Looking, Judgement-Based Supervision' (2013) 14 Journal of Banking Regulation 221, 225.

[829] Andromachi Georgosouli (2013), note 534, 63.

Besides the creation of the FCA, Sections 90 and 90A of the FSMA 2000 also show how the U.K.'s political economy and cultural traits shape its approach to securities liability.

The U.K.'s more lenient standard for *mens rea* highlights its preference for balanced accountability. Section 90 imposes near-strict liability for misstatements in prospectuses but allows a fault-based defence if the defendant can show they acted with reasonable care or diligence. It is worth noting that this openness contrasts with the U.S. approach under Section 11 of the Securities Act, which applies strict liability. Thus, this openness to a defence reflects a cultural scepticism toward aggressive litigation and a political-economic goal of not discouraging market participation.[830]

Similarly, Section 90A extends liability to cover continuous transparency obligations but kept a high threshold for claims.[831] Notably, it still requires that claimants show reasonable reliance. Compared to the U.S. fraud-on-the-market theory, this requirement of reliance reflects the U.K.'s more cautious and less litigious legal culture.

In sum, beyond the traditional British value of "gentlemanly problem solving," these provisions reflect the U.K.'s empirical pragmatism. In other

[830] See Chapter III Section 2.2.

[831] See Chapter III Section 2.4.

words, the *mens rea* standard limits liability to genuinely blameworthy conduct, safeguarding market efficiency from the chaos of over-enforcement.

The limited adoption of collective redress mechanisms further underscores the U.K.'s cautious regulatory approach, which reflects both political-economic priorities and cultural norms.

Politically, U.K. policymakers have historically resisted U.S.-style class actions due to fears of fostering "litigation abuse." Legislators have long viewed such mechanisms as carrying the potential risk of destabilising markets and deterring foreign investment.[832] Culturally, the British preference for discretion and consensus runs counter to adversarial mass litigation, which is often seen as disruptive and incompatible with the traditional "gentlemanly" way of resolving disputes. Of course, it should be noted that the introduction of an opt-out collective action regime in 2015 for competition law marked a cautious step forward. However, its narrow scope and significant procedural hurdles—such as the need for Tribunal certification—highlight the enduring influence of cultural and political-economic conservatism. Most importantly, the explicit exclusion of securities

[832] John C Coffee, 'The Globalization of Entrepreneurial Litigation: Law, Culture, and Incentives' in Sean Griffith, Jessica Erickson, David H Webber and Verity Winship (eds) (2018), note 279, 368 <https://doi.org/10.4337/9781786435347.00038> accessed 2 May 2025.

claims from this collective action regime once again confirms these underlying traits.[833]

Beyond the structure of collective litigation itself, other procedural features further reflect these tendencies.

The U.K.'s legislation keeps the "loser pays" cost rule, which shows it naturally discourages speculative and opportunistic claims, thereby reinforcing political and cultural resistance to reforming this procedural principle.[834] Similarly, restrictions on contingency fees signal a deep-seated aversion to adversarial litigation practices like the one in the U.S. model. Taken together, these factors ensure that collective redress remains marginal in U.K. securities enforcement, preserving a system that keeps away from a pro-litigation trajectory.

In conclusion, the U.K.'s securities institutions are fundamentally shaped by its political economy of pragmatic liberalism and cultural traits. These forces anchor a legislative logic that prioritises market efficiency, principles-based regulation, technocratic governance, and gentlemanly problem-solving, distinguishing it from the litigious U.S. pro-litigation model and China's state-centric approach. Institutions like the FCA and liability regimes under

[833] See Chapter III Section 3.2.

[834] See Chapter III Section 3.3.

the FSMA 2000 Sections 90 and 90A reflect a societal commitment to balancing investor protection with market competitiveness. While the U.K. has gradually adopted more interventionist measures post-2008, its enforcement remains conservative, avoiding disruptive litigation in favour of stability and institutional credibility. The cautious approach to collective redress echoes this duality. While the reform of CPO with the opt-out mechanism has become the exception in British collective actions, its exclusion in securities litigation underscores how political-economic priorities and cultural norms continue to shape a system that values adaptability, proportionality, and the preservation of London's status as a global financial hub.

3. The Scale of Securities Enforcement: How Market Size and Public Enforcement Limits Shape Securities Private Enforcement

Although the importance of private enforcement in securities markets is rooted in political economy and cultural contexts, the nature of securities enforcement, particularly the balance between public and private enforcement, has also undergone adjustment in all three jurisdictions in response to changes in market pressures, showing the effects of modern globalisation.

This adaptive process reflects the idea of institutional alignment, also found in *Varieties of Capitalism*, where the size of a market plays a key role in shaping how regulation is designed. As the research shows, small and large capital markets demand different institutional setups in order to function effectively. Moreover, while public enforcement is essential, its efficacy erodes when overburdened by excessive requirements due to inherent resource limitations.

Therefore, the design of a private enforcement regime must further carefully consider two key factors: (1) the expected size and role of the securities market, and (2) the effectiveness of public enforcement in protecting investors.

3.1 Fragmented Ownership & High Liquidity: Private Enforcement as A Necessity for U.S. Regulatory Architecture

Chapter II highlights that in the U.S., the design of private enforcement within securities institutions must be aligned with both the expected scale of enforcement demands in the securities market (the size and role of the market) and the effectiveness of public enforcement mechanisms.

A key theoretical point is that once the securities institutions rely too much on public enforcement, it would become inefficient due to diminishing marginal returns. This is because, as the market grows larger and more complex, regulators (public enforcement agencies) face escalating operational costs, bureaucratic inertia, and resource constraints. This makes it more impractical for them to deal with widespread or complicated misconduct.[835]

Specifically, as for public enforcement, it depends on government agencies like the SEC, which are funded by taxpayers. These agencies often face political limits on their budgets and go through periods of underfunding.[836] As markets expand, the fixed costs of monitoring and handling violations strain public resources, leading to underenforcement. In contrast, private enforcement spreads the costs among investors, law firms, and insurers, making lawsuits more closely tied to the financial interests involved. This reflects the idea behind Coasean bargaining, where private individuals are able to negotiate ideal outcomes without centralised government intervention.[837] Ultimately, the more investors are harmed, the more financial support private enforcement receives from the market—especially from law firms.

Private enforcement, which is driven by decentralised litigation and market-driven incentives exhibits superior scalability and cost-effectiveness.

[835] Eg Gary S. Becker (1968), note 593, 169-217.

[836] Howell E. Jackson and Mark J. Roe, 'Public and Private Enforcement of Securities Laws: Resource-Based Evidence' (2009) 93 Journal of Financial Economics 207, 226.

[837] Warren J. Samuels, 'The Coase Theorem and the Study of Law and Economics' (1974) 14 Natural Resources Journal 1, 19.

Drawing on Becker's theory of optimal enforcement, private individuals who sue to recover financial losses help reduce the pressure on public agencies by covering the costs of litigation themselves.[838] Furthermore, the Priest-Klein hypothesis suggests that private litigation fosters efficient dispute resolution by incentivising settlements and filtering frivolous claims.[839] Empirical studies, such as those analysing post-PSLRA outcomes, reveal that private litigation disproportionately deters misconduct in large, liquid markets where regulatory oversight is fragmented and not efficient enough.[840]

Additionally, deterrence theory highlights that private litigation multiplies the risks for violators by enabling numerous plaintiffs to pursue claims independently, amplifying accountability.[841] Thus, as the market grows and the number of investors increases, private enforcement can more effectively utilise decentralised resources and self-interest. This creates a level of overall efficiency that public enforcement alone cannot achieve.

Lastly, private enforcement's superiority in large markets also arises from its adaptability and superior access to localised information. Public agencies operate under rigid policy and jurisdictional frameworks, which often makes

[838] George J. Stigler, 'The Optimum Enforcement of Laws' (1970) 78 Journal of Political Economy 526-527.

[839] George L. Priest and Benjamin Klein, 'The Selection of Disputes for Litigation' (1984) 13 The Journal of Legal Studies 1-5.

[840] Stephen J. Choi, 'The Evidence on Securities Class Actions' (2004) 57 Vanderbilt Law Review 1465, 1486.

[841] A. Mitchell Polinsky and Steven Shavell, 'On Offense History and the Theory of Deterrence' (1998) 18 International Review of Law and Economics 305, 313.

them slow to keep up with fast-changing market developments like high-frequency trading or cryptocurrency fraud.[842] Private litigants, however, leverage market-specific knowledge and flexibility to tailor strategies to emerging risks. Consistent with Hayek's knowledge problem, decentralised actors use scattered information more effectively than centralised planners.[843] For example, whistleblower-supported *qui tam* lawsuits under Dodd-Frank show how private incentives help reveal hidden violations. Moreover, agency cost theory suggests that shareholders, as the ones who ultimately benefit or lose, have stronger reasons to oversee corporate behaviour than public regulators.[844] In large markets like the U.S., where enforcement gaps exist across global exchanges such as the NYSE and Nasdaq, private lawsuits serve as a self-adjusting system: the number of cases grows naturally with the size of the market and the limits of public enforcement.[845] This agility and informational asymmetry redress the "enforcement deficit" inherent in public systems, making private mechanisms indispensable in complex, scaled markets.

[842] Joseph E. Agolla and J. B. Van Lill, 'Public Sector Innovation Drivers: A Process Model' (2013) 34 Journal of Social Sciences 165, 171.

[843] Friedrich A. Von Hayek, 'Economics and Knowledge' (1937) 4(13) Economica 33, 53.

[844] William H. Meckling and Michael C. Jensen, 'Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure' (1976) 3 Journal of Financial Economics 305, 308.

[845] William B. Rubenstein (2004), note 783, 2146.

This analysis asserts a normative imperative: the design of a private securities enforcement regime should be calibrated to the market's projected scale and public enforcement's efficacy. There are limits to public enforcement expansion, which is economically untenable; hence, private mechanisms—through cost decentralisation, adaptability, and deterrence—could be a complementarity to optimise investor protection in large, dynamic markets.

3.2 Institutional Concentration & Moderate Liquidity: Resource-Adequate Hybrid Enforcement in the U.K.

The U.K. securities market is one of the largest globally, with the London Stock Exchange (LSE) ranking as one of the largest stock exchanges by market capitalisation (over $3.42 trillion as of 2024) and a critical hub for international capital flows.[846] The market's scale is amplified by its role as a gateway for cross-border investment, hosting over 1,500 listed companies, including multinational giants like AstraZeneca, Shell, and HSBC.[847] However, unlike the U.S., where the NYSE and NASDAQ exceed $40 trillion in combined market cap, the U.K. market is more concentrated in traditional sectors (finance, energy) and lacks the hyper-scaled tech dominance seen in

[846] 'The Largest Stock Exchanges in the World capital.com (July 2024), accessed 16 December 2024.

[847] <https://www.morningstar.com.au/investments/security/LSE> accessed 16 December 2024.

Silicon Valley listings.[848] Theoretically, this scale aligns with the bargaining principles where a large but concentrated market reduces transaction costs for public enforcement, as regulators like the FCA can prioritise systemic oversight over fragmented retail disputes.

The U.K. securities market is notably less “active” than its U.S. counterpart in terms of liquidity and trading volumes, which diminishes the need for aggressive private enforcement. While the average daily closing auction of the NYSE exceeds $18.9 billion,[849] the LSE’s average daily turnover is around £8 billion,[850] reflecting lower participation. As a result, the relatively low market activity does not contribute to a necessity of high demand for securities enforcement in the U.K. market.

The U.K.’s public enforcement framework is sufficiently resourced relative to its market scale. The FCA operates with a budget of £587 million[851] (2020) and a staff of over 4,000[852], enabling proactive oversight of the LSE and ancillary markets. While this pales in comparison to the U.S. SEC—

[848] <https://www.lseg.com/en/insights/ftse-russell/the-uks-very-global-country-index> accessed 16 December 2024.

[849] <https://www.nyse.com/trading-data> accessed 16 December 2024.

[850] <https://georgiacapital.ge/investor-toolkit/share-price-liquidity> accessed 16 December 2024.

[851] FCA, *Annual Report and Accounts 2020/21* (2021) 24.

[852] Ibid [69].

which commands a $1.7 billion[853] (2020) budget and 4,500 employees[854]—the disparity reflects structural differences in market size and enforcement efficiency. The U.S. securities market's capitalisation is approximately 10 times larger than the U.K.'s (£4.2 trillion vs. $50 trillion for NYSE and NASDAQ),[855] yet the SEC's budget is only 3 times larger, and its staff size merely 1.1 times greater. Relative to market size, the U.K. allocates significantly more resources per unit of capitalisation, ensuring robust public enforcement without excessive expenditure.

Furthermore, the U.K.'s market structure reduces regulatory complexity. Unlike the U.S., where market capitalisation is dispersed across thousands of listed firms and retail investors, the U.K. market is highly concentrated in large institutional investors. Notably, over 60% of FTSE 100 equity is held by foreign institutional investors.[856] Although it is a shift from earlier domestic institutional dominance, this foreign ownership concentration—driven by passive strategies like index funds—reduces litigation incentives compared to the U.S., where high-frequency trading and retail speculation

[853] SEC, *Fiscal Year 2020 Congressional Budget Justification Annual Performance Plan* (2020) 19.

[854] Ibid [15].

[855] <https://data.worldbank.org/indicator/CM.MKT.LCAP.CD> accessed 2 May 2025.

[856] Sebastian Segerstrom, 'Institutional Ownership in the UK: Companies and Markets' (22 July 2020) FactSet Insight <https://insight.factset.com/institutional-ownership-in-the-uk> accessed 9 April 2025.

amplify private enforcement demand.[857] This concentration means fewer entities require direct oversight, lowering the per-capita regulatory burden.

Returning to the design of securities institutions, the U.K.'s hybrid enforcement framework—built on well-resourced compared to the U.S., public oversight and limited private actions (such as those under FSMA 2000 Sections 90/90A and GLO)—echoes the traits of its market: moderate liquidity, a strong presence of institutional investors, and a trend toward passive investment strategies. Specifically, while the FCA faces critiques over procedural delays and cross-border gaps, its focus on systemic stability over retail disputes suits a market where over 60% of equity is held by risk-averse institutions. Thus, the pragmatic and strategic use of limited private litigation helps to subtly mitigate risks arising from lower market activity, ensuring enforcement remains cost-effective without sacrificing deterrence. Accordingly, Section 90, Section 90A and GLO serve as an appropriate reactive tool, complementing the market's unique needs. This hybrid approach ensures that enforcement is tailored to the specific characteristics of the U.K. market.

3.3 State-Owned Dominance & Structural Homogeneity: Politically Embedded Enforcement in China

[857] Marc Goergen and Luc Renneboog, 'Strong Managers and Passive Institutional Investors in the UK' (Nota di Lavoro No 21.1999, Fondazione Eni Enrico Mattei 1999) 12.

China's securities market ranks as the second-largest globally, with the combined market capitalisation of the Shanghai Stock Exchange and Shenzhen Stock Exchange exceeding $10 trillion in 2023.[858] This immense scale is underpinned by the dominance of SOEs, which account for over 40% of the total market value.[859] Giants like Industrial and Commercial Bank of China (ICBC), China Mobile, and PetroChina exemplify the SOE-driven structure, reflecting the state's strategic control over key economic sectors. Despite hosting over 5,000 listed companies, the market remains heavily concentrated in traditional industries such as energy, finance, and manufacturing.[860] This concentration aligns with Resource Dependence Theory.[861] That is, SOEs, as politically and economically pivotal entities, absorb disproportionate regulatory attention, while the lack of sectoral diversification simplifies oversight. Comparatively, the U.S. and U.K. markets exhibit greater sectoral diversification, necessitating more complex enforcement frameworks.

On February 17, 2023, the CSRC officially released the supporting business rules for the implementation of the registration-based system for

[858] <https://data.worldbank.org/indicator/CM.MKT.LCAP.CD> accessed 2 May 2025.

[859] Andrew Z. Szamosszegi and Cole Kyle, *An Analysis of State-Owned Enterprises and State Capitalism in China*, vol. 7 (Washington, DC: US-China Economic and Security Review Commission, 2011) 1.

[860] <https://www.marketscreener.com/stock-exchange/shares/asia/china-125/> accessed 2 May 2025.

[861] Jeffrey Pfeffer and Gerald Salancik, 'External Control of Organizations—Resource Dependence Perspective' in John B. Miner (ed), *Organizational Behaviour* 2 (Routledge, 2015) 355.

stock issuance, marking the fundamental establishment of the institutional framework for the registration-based reform in China's capital markets. However, prior to this reform, China's capital markets had long operated under an approval system characterised by "strict entry and stringent regulation."[862] Under this regime, securities regulators were required not only to conduct substantive reviews of issuers' information disclosure documents but also to comprehensively evaluate financial indicators such as asset quality and profitability of issuing entities, effectively performing the function of securities value judgment. Through this front-end access control mechanism, regulatory authorities implemented a thorough substantive review of enterprises seeking listing, which significantly reduced the occurrence probability of illegal activities such as financial fraud and information deception. This indicates that despite China's vast market scale, the CSRC's stringent gatekeeping role in the early stages of the market has significantly limited the incidence of fraud requiring regulatory intervention. Consequently, the CSRC's public enforcement burden may be proportionally lower than what the market's sheer size alone would suggest.

The CSRC demonstrates remarkable cost efficiency in regulatory resource allocation relative to market size. In 2023, the CSRC operated with

[862] Zhao Qianyu and Hao Lei, 'Research on the Imbalance of Responsibilities between Sponsors and Sponsor Representatives under the Registration System' (2024) 1 Tianjin Legal Science 24, 29.（赵阡羽、郝磊：《注册制背景下保荐人与保荐代表人责任失衡问题研究》，载《天津法学》2024 年第 1 期，第 29 页）

a budget of ¥2.24 billion[863] ($0.34 billion at exchange rates) and a workforce of 3,590 employees (2022)[864]. The U.S. securities market's capitalisation is approximately 5 times larger than China's. Although based on exchange rates, the SEC's budget is 7 times larger than China's, considering purchasing power parity (PPP), the CSRC's budget is roughly 1/3 of the SEC's. Moreover, compared to the U.S., China's staff size appears to be very adequate. Therefore, as the second-largest securities market, China allocates significantly more resources per unit of capitalisation.

China's market concentration with dual oversight mechanisms, further creates efficiencies. A large portion of China's securities market capitalisation is held by SOEs. These enterprises, which are crucial to China's economy, are subject to dual oversight by the CSRC and other government entities, such as the State-Owned Assets Supervision and Administration Commission (SASAC).[865] The involvement of multiple regulatory bodies overseeing the financial activities of these SOEs complicates the allocation of resources by the CSRC, potentially reducing the efficiency of enforcement.[866]

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[863] CSRC, *2023 Annual Department Budget of the China Securities Regulatory Commission* (2023) 7.（中国证券监督管理委员会，《2023 年度中国证监会部门预算》，2023 年，第 7 页）

[864] CSRC, *Annual Report of the China Securities Regulatory Commission* (2022) 11.（中国证券监督管理委员会，《中国证券监督管理委员会年报（2022 年）》，2022 年，第 11 页）

[865] Zhao Wanyi, 'The Design and Implementation Path of Compliance Systems in Corporate Law' (2020) 2 China Legal Science 69, 79.（赵万一，《合规制度的公司法设计及其实现路径》，载《中国法学》2020 年第 2 期，第 79 页）

[866] Geng Lihang, 'Questioning the Function of Civil Liability in Securities Insider Trading' (2010) 6 Chinese Journal of Law 77-78.（耿利航，《证券内幕交易民事责任功能质疑》，载《法学研究》2010 年第 6 期，第 77-78 页）

This contrasts sharply with the U.K.'s "twin peaks" model (separation of supervision), where the FCA can singularly oversee market conduct, minimising jurisdictional overlaps.[867] However, for SOEs, the SASAC singularly holds direct regulatory, approval, and supervisory authority over many matters. This means that in areas such as capital operations, compliance with information disclosure requirements, and risk management involving SOEs (corporate governance), the CSRC does not need to bear the full burden of review and enforcement on its own. In other words, the involvement of SASAC and other agencies helps share part of the CSRC's regulatory workload, which may facilitate the focus and impact of its own regulatory efforts.

On the other hand, sectoral concentration facilitates cost-effective regulation by enabling the CSRC to implement industry-specific frameworks with standardised regulatory targets. This approach reduces information asymmetry and minimises unpredictability in enforcement.[868] For instance, if the CSRC prioritises monitoring financial misreporting in high-risk sectors such as SOEs or banks, it could focus on standardising certain audit protocols and streamlining enforcement mechanisms. This approach would enhance

[867] See Chapter III Section 4.1.

[868] Zhao Wanyi and Wang Peng, 'On the Legal Realization Route of Synthetical and Harmonized Regulating Corporates Compliance Behaviours in China' (2021) 7 Hebei Law Science 58, 60.（赵万一、王鹏，《论我国公司合规行为综合协同调整的法律实现路径》，载《河北法学》2021 年第 7 期，第 60 页）

investigative efficiency while reinforcing compliance within these critical sectors. By contrast, the SEC has to grapple with a wide array of violations (diverse sectors)—from crypto fraud to AI-driven insider trading—requiring bespoke solutions. Thus, to some extent, based on the structure of sectoral concentration, China's cost-benefit ratio in public enforcement outperforms decentralised markets.

China's regulatory framework exemplifies the principle that securities litigation systems must calibrate private enforcement to market scale and public efficacy. The dominance of SOEs and high sectoral concentration reduces market liquidity given the prevalence of non-tradable SOE shares and regulatory complexity, enabling the CSRC to achieve high public enforcement efficiency.

However, as China's capital markets have grown, the balance with mobilising market discipline, and gradually allowing private enforcement to complement policing of the capital markets, has become imperative. Further, the challenge of limited budgets for public enforcement means that dual oversight mechanisms provide regulatory efficacy overall for securities market governance. Thus, the design of private enforcement in China reflects an SRL model, in which the CSISC, as a sub-department of the CSRC, maintains firm control over the initiation of securities litigation. This approach helps avoid opening the floodgates to mass litigation. Based on the analysis above, this is grounded in the view that, compared to the U.S., China's public enforcement system appears sufficiently capable of enforcing securities laws. At the same time, it offers support—albeit cautiously—for investor claims. All in all, private enforcement serves a limited, state-guided function.

4. Path Dependence within Securities Enforcement: How the Balance of Deterrence and Compensation under Public and Private Enforcement Shapes Securities Enforcement

The design of private enforcement systems must account for the interaction between deterrence and compensation objectives, ensuring that liability rules and procedural incentives encourage compliance without discouraging productive risk-taking. An effective framework should calibrate public sanctions (e.g. restitution order), litigation incentives (e.g. contingency fee agreement), and evidentiary burdens (e.g. causes of action) to prevent both under-enforcement and the chilling of legitimate market activity.

4.1 Lessons from the Analysis of Securities Enforcement in the U.K.

The analysis in Chapter III highlights the critical role of institutional complementarity between public and private enforcement in optimising securities law effectiveness.

Drawing on theories of regulatory design by scholars like La Porta et al.,[869] the U.K. framework demonstrates that neither public nor private enforcement alone suffices. In effect, it is the interaction between the two that shapes overall institutional effectiveness and efficiency. Specifically, public enforcement, led by agencies like the FCA, prioritises deterrence through penalties and market oversight. In contrast, private enforcement—via mechanisms such as collective actions—focuses on compensating harmed investors. This dual enforcement aligns with the "responsive regulation" model proposed by Ayres and Braithwaite, where hybrid systems balance punitive and restorative justice.[870]

However, although the balance of deterrence and compensation is important, overemphasising them risks destabilising market confidence. Specifically, excessive reliance on deterrence (e.g. harsh penalties for non-compliance) and compensation (e.g. high liability damage) risks destabilising market confidence through multiple enforcement channels.[871]

[869] R La Porta et al. (2006), note 3, 27-28.

[870] Ian Ayres and John Braithwaite, *Responsive Regulation: Transcending the Deregulation Debate* (Oxford University Press 1992) 20.

[871] Gary S. Becker (1968), note 593, 169-217.

In effect, firstly, stringent regulatory penalties combined with high litigation risks together disproportionately increase compliance costs for listing in the securities market. Next, over-deterrence can distort market behaviour by incentivising excessive risk aversion. For example, firms may avoid high-risk, high-reward ventures—such as experimental fintech projects—in order to evade regulatory scrutiny, ultimately reducing market dynamism. Meanwhile, if enforcement is unpredictable or applied repeatedly after the fact, it would erode issuers' confidence in the market. For example, after the 2008 financial crisis, the complex rules in the Dodd-Frank Act led banks to focus more on following regulations than on lending money, which caused a slowdown in credit. Taken together, these effects create a "chilling effect," where fear of punishment becomes stronger than listing incentives. As a result, as in a "lemon market" investors may move their money elsewhere.

Beyond the risk of overemphasis, the system cannot rely exclusively on one objective; both deterrence and compensation must coexist within the enforcement framework. Here, each securities enforcement function of deterrence or compensation is crucial for economic development individually. Separately, deterrence, based on Becker's rational choice theory, discourages misconduct by imposing costs (e.g. fines, criminal liability) that outweigh the illicit gains.[872] In contrast, compensation, shown in Calabresi's principles of corrective justice, aims to restore investors' losses, and it thereby ensures investors continue market participation.[873]

The above theories seem to show that each function has an independent enforcement role in the system. However, the effects of deterrence and compensation are interdependent, and an effective deterrence is able to minimise damage, thereby reducing the need for compensation. Meanwhile, efficient compensation reinforces restitution from violators, weakening their reputation and then deterring future violations. Therefore, if the system has already overemphasised compensation, it may undermine the need for deterrent effects. Similarly, if the legislation leans heavily on deterrence, the whole system may need less compensation in favour of harmed investors. For instance, if regulators prioritise compensating harmed investors (e.g. through settlements or fines redirected to investors), violators may perceive this compensation as a "cost of doing business" and a punitive effect, deterring their future violations.

Therefore, the system's design should avoid focusing too much on any single part alone (overemphasising effect) and should also consider the

[872] Ibid.

[873] Guido Calabresi, *The Cost of Accidents: A Legal and Economic Analysis* (Yale University Press, 2008) 301.

interdependent effect. Over-deterrence theory, articulated by Arlen and Kraakman, posits that well-designed "effect" not only should deter misconduct but also allow corporates to engage with reasonable risk-taking.[874] The optimal balance, as theorised by Polinsky and Shavell, further suggests that "effect" should be accessible without being exploitative.[875] Taken together, overlapping enforcement risks, no matter from duality or unitarity, lead to an over-deterrence effect. Such effect can violate Arlen and Kraakman's principle of proportionality, ultimately pressuring issuers into excessive caution and over-compliance, which undermines the securities market dynamism.[876] For example, post-Enron reforms like SOX increased compliance costs. This burdens smaller firms, disincentivises business risk-taking and reduces IPO activity.[877] This "chilling effect" may undermine market liquidity and competitiveness. Thus, while deterrence is essential, its institutional design must account for cumulative impacts.

Back to the design of private enforcement, securities litigation aims to balance both deterrence and compensation, and if the reformed securities litigation shows institutionally excessive aggregate deterrence stemming

[874] Eg Jennifer Arlen and Reinier Kraakman, 'Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes' (1997) 72 New York University Law Review 687, 745.

[875] A. Mitchell Polinsky and Steven Shavell, 'The Economic Theory of Public Enforcement of Law' (2000) 38 Journal of Economic Literature 45, 70-76.

[876] John C. Coffee Jr, 'Crime and the Corporation: Making the Punishment Fit the Corporation' (2021) 47 Journal of Corporation Law 963, 976.

[877] Aiyesha Dey, 'The Chilling Effect of Sarbanes–Oxley: A Discussion of Sarbanes–Oxley and Corporate Risk-Taking' (2010) 49 Journal of Accounting and Economics 53, 54-55.

from overlapping public and private actions, it ultimately can paradoxically compromise the securities market. (It will be further elaborated in Section 4.3.) Hence, the design of private securities enforcement should institutionally complement public securities enforcement to avoid systemic over-deterrence. Thus, policymakers must apply the “Goldilocks principle” and adopt a holistic deterrence-test framework, weighing deterrence benefits against compliance burdens. Only through such calibrated complementarity can enforcement preserve market confidence without stifling economic dynamism—a lesson critical for evolving jurisdictions navigating the tightrope between investor justice and market efficiency.

4.2 Path Dependence and Enforcement Balancing in China’s Securities Institutions

China’s securities regulatory framework is characterised by a pronounced reliance on public enforcement, reflecting a state-centric model of market governance. The CSRC, as the primary legal enforcer, wields extensive authority to investigate and penalise misconduct under the Securities Law (2019), including imposing fines of up to 10 times the illegal gains (Article 190) and lifetime market bans for egregious fraud (Article 191).

The formation of this framework is rooted in its economic model. Economically, China’s approach mirrors the “developmental state” model, where a strong and government-interventional enforcement supports state-led growth, akin to post-war Japan and South Korea but with greater emphasis on deterring systemic financial risks.[878] This aligns with Coffee's theory of "public enforcement superiority" in emerging markets. Here, Coffee claimed that a market with underdeveloped judicial systems and limited investor legal capacity necessitate state intervention to maintain market order.[879] Thus, as these traits have shown, securities legislation in China strategically integrates deterrence, compensation, and economic growth objectives, albeit with a tilt toward state-managed market stability.

The state-managed model means the public enforcement is equipped with a wide range of functions, and thereby legislation shall be extremely cautious when reforming private enforcement. For instance, while deterrence is codified in Securities Law (2019), Articles 185–192, compensation remains secondary, as seen in Article 95's SRL, which allows the state-controlled CSISC to initiate collective suits.[880] The reason why lawmakers retained exclusive authority to initiate the "opt-out" SRL is because China's securities institutions already have a rigorously plaintiff-friendly liability (unitary liability framework). With this unitary liability framework, an overly activate

[878] Robert Wade, 'Industrial Policy in East Asia: Does It Lead or Follow the Market?' in Gary Gereffi and Donald L Wyman (eds), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia* (Princeton University Press 1990) 231.

[879] John C. Coffee Jr (2007), note 18, 976.

[880] See Chapter IV Section 3.1.

SRL may create systemic risks of over-deterrence. Besides the exclusive authority to initiate the SRL, its activation requires CSISC approval and a 50-investor threshold. That is, when China's Securities Law (2019) introduced the SRL, the legislation shall have a groundbreaking yet cautious step toward private enforcement reform.

Moreover, the existing *mens rea* and joint liability framework has shown that there is a potential for over-deterrence. Here, policymakers explicitly acknowledged that the Securities Law (2019) holds institutions (e.g. auditors, underwriters) jointly liable for even minor negligence, a rule derived from Article 163, which could cause over-deterrence and distort market incentives. In practice, warnings from the National People's Congress (NPC) have stated "litigation equals bankruptcy" dynamics, advocating that there is an over-deterrence risk for defendants.[881] To mitigate this, legislative safeguards were introduced through judicial interpretation, which are trying to require courts to apply joint liability only when defendants have fraudulent intent rather than merely negligence.[882] This judicial interpretation shows that concerns about

[881] Supreme People's Court of the People's Republic of China, 'Response to Proposal No. 0111 of the Fifth Session of the 13th National People's Congress' (9 January 2023).（最高人民法院，《对十三届全国人大五次会议第 0111 号建议的答复》，2023 年 1 月 9 日发布）

[882] Supreme People's Court, *Judicial Interpretation* (2022), note 635, Article 14. However, judicial interpretation cannot overrule what Law specifies. Therefore, whether these safeguards could be judicially valid is still controversial.

over-deterrence have always been present in China's securities institutional reform.

In conclusion, China's securities enforcement model exemplifies a calculated hybridisation, positioning private litigation as a state-steered supplement to public mechanisms. By centralising class action authority in the CSISC and calibrating liability standards, policymakers can avoid the "over-deterrence trap" seen in 1980s U.S. markets. For emerging economies, China's experiment can offer a template for leveraging private enforcement as a semi-regulatory tool rather than a driver of market governance—a pragmatic middle ground in the global debate over state versus market supremacy in finance.

4.3 Path Dependence and Enforcement Balancing in U.S.'s Securities Institutions

The U.S. legal system's emphasis on private enforcement as a default mechanism to rectify corporate misconduct reflects its foundational commitment to individual rights and decentralised accountability. While the SEC was established in 1934 under the Securities Exchange Act to centralise oversight of the securities markets, Congress allowed class action rules based on the FRCP to operate in this field, creating a dual enforcement paradigm.

However, the historical trajectory reveals a lack of deliberate institutional complementarity at the very beginning. The SEC's capacity fluctuated with political and budgetary cycles rather than the effectiveness of legal enforcement—for instance, its enforcement division faced significant resource constraints during the Reagan administration's deregulatory push in the 1980s.[883] During this deregulation, private enforcement surged in the 1960s–1980s as plaintiff attorneys capitalised on favourable procedural rules. Legal scholar Roberta Romano notes that this period saw a "privatisation of enforcement," where securities enforcement primarily outsourced regulatory functions to private litigation in the courts.[884] Yet, this phenomenon ignored systemic risks, such as misaligned incentives for entrepreneurial attorneys, who often prioritised high-volume, low-merit cases to secure quick settlements. The result was that entrepreneurial attorneys routinely pursued class actions targeting disclosure violations, often settling for "pennies on the dollar" without meaningful investor compensation.[885] Thus, this legislative history reflects an institutional blind spot—failing to calibrate how these dual forces might interact to produce over-deterrence.

[883] Eg Thomas W. McGarity, 'Regulatory Reform in the Reagan Era' (1986) 45 Maryland Law Review 253, 254-256.

[884] John C. Coates IV, 'Private vs. Political Choice of Securities Regulation: A Political Cost/Benefit Analysis' (2000) 41 Virginia Journal of International Law 531, 544.

[885] Richard M. Phillips and Gilbert C. Miller, 'The Private Securities Litigation Reform Act of 1995: Rebalancing Litigation Risks and Rewards for Class Action Plaintiffs, Defendants and Lawyers' (1995) 51 Business Lawyer 1009, 1030.

By the 1990s, the unchecked rise of private enforcement had resulted in systemic over-deterrence, ultimately distorting the functioning of U.S. securities markets. Apart from "strike suits," issuers faced a "blackmail dilemma" where even frivolous suits imposed reputational damage and litigation costs. Those damages force firms to settle rather than risk prolonged court battles,[886] and this dynamic distorted corporate behaviour.

The rise of private enforcement would lead to an over-deterrence effect. According to empirical research by PwC, if litigious liability risks increase, the disclosure costs solely attributable to auditing would rise by one-fifth. This is because stricter requirements, aimed at mitigating liability risks, lead to more rigorous compliance review processes, making information disclosure both costly and time-consuming.[887] Furthermore, the study highlights that the cost issuers are willing to invest in verifying the accuracy of statements is positively correlated with the expected benefits these statements bring to them.[888] Therefore, if relatively more litigious liability risks are applied, higher disclosure costs will reduce the timeliness, truthfulness, accuracy, and completeness of continuing market disclosures.

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[886] Charles Silver, 'We're Scared to Death: Class Certification and Blackmail' (2003) 78 New York University Law Review 1357, 1359.

[887] Paul Davies (2007), note 463, 30.

[888] Niklas Ström, Information Disclosure: Content, Consequence and Relevance (Doctoral Dissertation, Uppsala University, Department of Business Studies 2006) 11.

Further, this increasing cost may lead to a market failure. In certain situations, higher disclosure costs can lead to delays in the timeliness of *ad hoc* disclosures. For instance, during the phase of continuing information disclosure, companies often need to disclose relevant information on an *ad hoc* basis, rather than following pre-planned prospectuses or periodic disclosure standards. If these disclosures also entail high liability risks, this will create compliance challenges. This is because issuers require sufficient time to carefully review and prepare information to avoid incurring high liability costs. If issuers anticipate that the disclosed information will contribute to business growth and stock price appreciation, implying lower relative disclosure costs, they will be more willing to invest in timely, truthful, accurate, and complete disclosures. On the other hand, issuers can be improperly motivated to hide or postpone such disclosures if the anticipated benefits are less than the disclosure costs. Studies also indicate that overly high litigious liability risks during the continuous disclosure phase can undermine the truthfulness, accuracy, and completeness of disclosures. This is because excessive liability risks may lead to the misuse of information disclosure as a primary tool to avoid liability. In particular, the abuse of continuous disclosures can negatively impact investor interests and the overall health of the securities market. Such disclosures create “noise” in the market, which leads investors to inappropriately rely on false information. It ultimately compromises investors' ability to discern the true value of securities.[889]

Next, over-deterrence also skewed corporate governance where boards prioritised short-term risk mitigation, such as avoiding bold strategic moves, over innovation. Study criticised this behavioural effect as a "tax on capital formation," arguing that excessive litigation chilled market dynamism.[890] The failure to institutionally calibrate public and private enforcement thus undermined the very efficiency and investor confidence, and it revealed the perils of uncoordinated deterrence regimes.

With those considerations, Congress and federal courts enacted targeted reforms during the 1990s and 2000s in response to widespread litigation abuses. These reforms sought to curb opportunistic and entrepreneurial legal practices while preserving effective private enforcement for investor redress.

Firstly, the PSLRA of 1995 set up procedural filters to deter frivolous suits and align litigation incentives with shareholder interests. Beyond requiring plaintiffs to specify fraudulent statements with particularity, the PSLRA imposed a mandatory "stay of discovery" during motions to dismiss, which prevents representatives from using costly litigation as leverage to force

[889] Stanley Baiman and Robert E. Verrecchia, 'The Relation among Capital Markets, Financial Disclosure, Production Efficiency, and Insider Trading' (1996) 34(1) Journal of Accounting Research 1, 3-5.

[890] Eg John R. Boatright, 'Reluctant Guardians: The Moral Responsibility of Gatekeepers' (2007) 17(4) Business Ethics Quarterly 613, 621.

defendants to settle a deal.[891] Its "safe harbour" provision protected companies from liability for forward-looking statements if accompanied by meaningful cautionary language.[892] The Act's representative plaintiff provision prioritises institutional investors like pension funds with the largest financial stakes. This reduced the power of "professional plaintiffs" who often joined lawsuits just to help lawyers earn fees.[893]

Second, by prohibiting state courts from hearing the majority of securities class actions involving nationally traded securities, the SLUSA of 1998 addressed jurisdictional fragmentation. Before SLUSA, plaintiffs engaged in "race-to-the-bottom" forum shopping, strategically filing lawsuits in "advantageous states" such as California, where courts adopted pro-investor laws that were often hostile to issuers.[894] For instance, the *Diamond Multimedia* decision allowed class actions to bypass federal reforms by relying on state "qualified purchaser" standards.[895] Its decision indirectly became plaintiffs' standing to have a litigation in California even there could be a conflict of jurisdiction. In effect, SLUSA closed this loophole by making

[891] Brian Philip Murray, 'Lifting the PSLRA Automatic Stay of Discovery' (2004) 80 Notre Dame Law Review 405, 407.

[892] Ann Morales Olazábal, 'False Forward-Looking Statements and the PSLRA's Safe Harbor' (2011) 86 Indiana Law Journal 595, 632-636.

[893] Tiffany M. Wong, 'Defendants' Standing to Oppose Lead Plaintiff Appointment Under the Private Securities Litigation Reform Act of 1995' (2003) 1 University of Chicago Legal Forum 833, 834-835.

[894] Richard W. Painter, 'Responding to a False Alarm: Federal Preemption of State Securities Fraud Causes of Action' (1998) 84 Cornell Law Review 1, 36-39.

[895] *Diamond Multimedia Systems, Inc. v. Superior Court*, 19 Cal.4th 1036, 80 Cal. Rptr. 2d 828, 968 P.2d 539 (Cal. 1999).

almost all securities cases federal, ensuring the PSLRA's tougher rules could be applied consistently.

Thirdly, federal courts reinforced these statutory reforms by tightening liability thresholds through pivotal rulings (precedents). For instance, in *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, the Supreme Court mandated that plaintiffs demonstrate a "cogent and compelling" inference of scienter (intent to defraud) that is "at least as likely as any opposing inference" of innocence.[896] This "strong inference" standard forced plaintiffs to present evidence of deliberate misconduct, not just negligence or post hoc speculation.[897] Similarly, *Dura Pharmaceuticals, Inc. v. Broudo* rejected the "inflated purchase price" theory, and this case requires plaintiffs to prove that stock declines directly resulted from fraudulent statements not by market fluctuations or external factors.[898] Collectively, these decisions reinterpreted the substantive elements of causes of action, making it more challenging to prove the defendants' liability.

The U.S. experience reveals a general lack of institutional coordination and reactive regulatory measures. This phenomenon is embedded in the nation's unique institutional landscape, where the decentralised power

[896] *Tellabs Inc. v. Makor Issues & Rights* (2007), note 200.

[897] Victoria Su, 'Scienter After Tellabs' (2010) 5 Brooklyn Journal of Corporate, Financial & Commercial Law 527, 530.

[898] *Dura Pharmaceuticals, Inc. v. Broudo,* 544 U.S. 336 (2005).

structure of federalism and the common law tradition have jointly shaped a regulatory ecosystem that “evolves through chaos.” Although the fragmented governance system has rendered tentative reforms like the PSLRA, the common law tradition strengthens the effect from those institutional reforms through the judiciary’s dynamic feedback mechanisms. Admittedly, when political polarisation paralyses top-down institutional design, market actors and the judicial system collaboratively generate alternative governance networks, converting institutional friction into adaptive momentum for evolution. This “order within chaos” exemplifies the core strength of the common law system.

However, it should be noted that “order within chaos” does not imply that policymakers disregard the institutional design of securities enforcement. Instead, the historical trajectory—from periods of deregulation and the rise of private litigation, to the enactment of the PSLRA and the development of judicial precedents—reveals that the U.S. securities institutions, through passive developments (chaos) and an active reform (order), have developed a more holistic deterrence-test framework that integrates the social benefits of enforcement, compliance costs, and market vitality. It is against this backdrop that the current form of the modified class action has emerged.

5. Conclusion: Reassessing Securities Litigation Reform Through Comparative Institutional Complementarity

The securities litigation systems in the U.S., the U.K., and China each reflect the distinct considerations that shape their respective approaches to securities litigation. As part of achieving investor protection in important capital markets, while each jurisdiction's approach may benefit from improvement, the pluralism of approaches each achieves their own functional efficiencies, institutional coherence and policy objectives. In that way, reform should also be nested within that framework of comparative institutional complementarity, particularly when reform may be instigated based on the desirability of perceived transplantation from a successful capital market.

5.1 Core Elements of Reassessing Securities Litigation Reform

The reconstruction of securities enforcement systems fundamentally involves systematic decoding and reorganisation of institutional DNA. Institutional transplantation must treat indigenous elements as a "translation medium," where political-economic structures and cultural traditions form the coding rules of institutional genes. For instance, China's institutional feature of "mobilising resources for major national priorities" inherently embeds securities enforcement with a strategic national character. The adversarial legal culture in the U.S. has shaped a private enforcement-dominated market ecosystem, where historical factors continue to expand litigation boundaries despite legislative efforts to curb frivolous lawsuits. The U.K.'s tradition of "gentlemanly capitalism" has fostered a unique self-regulatory paradigm, balancing business and institutional investors' self-governance with legal deterrence. These institutional genes define the threshold and direction for systemic reforms, as any deviation from their inherent traits risk triggering institutional rejection.

Next, the calibration of securities enforcement systems should be dynamic to precise market, institutional and legal needs. In retail investor-dominated, highly volatile markets, overreliance on public enforcement is risky. This is because as the market grows, the benefits of public enforcement decrease over time. Therefore, in such market conditions, it is necessary to strengthen private enforcement to some extent. Conversely, in markets with underdeveloped institutional investors and immature judicial mechanisms, robust public enforcement better nurtures capital formation. In these cases, private enforcement should play a supporting—but limited—role. Thus, the institutional design should be responsive to "market evolutionary logic": establishing compliance benchmarks through public enforcement during nascent stages to guide orderly market development; introducing limited private remedies during growth phases to cultivate self-regulatory capacity; and constructing pro-private governance at maturity.

Certainly, existing institutional path dependencies serve both as historical burdens and springboards for innovation. While U.S. securities class actions suffer from litigation abuse, the following reforms of private enforcement—rather than in turn prioritising public enforcement alone—have shaped the class action into a better third force of civic oversight in market governance. Similarly, China's incremental implementation of SRL demonstrates political wisdom in unleashing "bottom-up" energy within a centralised framework. Thus, it should be noted that institutional evolution thrives not necessarily on disruptive innovation but on activating latent potential through the recombination of existing and upcoming routes. This path dependence consideration preserves institutional stability while injecting evolutionary momentum into systemic upgrades.

5.2 Methodologies for Reassessing Securities Litigation Reform

Step 1: Securities litigation legislation should be constructed as a dynamic governance framework compatible with local institutional foundations. Legislative innovation requires systematic analysis of the interactions among political-economic landscapes and cultural traditions. For example, in China, legislators must leverage the "mobilising resources for major national priorities" institutional trait. Investor protection innovations aim to harmonise national governance objectives with market demands. Thus, when adopting a U.S.-style litigation framework, China should integrate public interest to ensure balance and mitigate potential adversarial cultural clashes. Similarly, when implementing a U.K.-style securities litigation framework, China should consider whether peer-level consensus-building between corporations and investors could help refine the country's broader market development strategy. All in all, this demands pre-emptive legislative compatibility assessments to predict any risks of legal transplantation.

Step 2: Market developmental stages constitute the second dimension of legislative design. For emerging markets dominated by retail investors and volatility, legislation may prioritise public enforcement, using regulator-led penalties and market bans to establish compliance baselines. During investor and market cultivation phases, controlled private litigation channels—with shareholding thresholds, damage caps, and administrative pre-certification—can progressively foster rule-of-law awareness. Mature markets require synergistic networks between regulatory enforcement and judicial litigation, such as converting administrative fines into litigation compensation funds to channel regulatory efficacy into investor relief. Meanwhile, gradually expanding private enforcement can offset the diminishing effectiveness of public oversight over time. This phased strategy dynamically optimises legislative resource allocation to balance regulatory intensity with market maturity. For instance, the U.K. securities market has distinct characteristics that require careful consideration when implementing securities litigation reforms. While adopting a U.S.-style litigation framework, the U.K. must account for its smaller scale and lower liquidity compared to the U.S., suggesting a need for limited private enforcement. Moreover, given the U.K.'s history of securities market and its large institutional investor base—which aligns with late-stage investor cultivation—relying primarily on public enforcement to enable private litigation may not be the optimal market approach. Instead, a balanced system tailored to local market conditions would be more effective.

Step 3: Finally, creative reinvention of existing institutional functions offers pragmatic pathways for legislative breakthroughs. Securities litigation legislation should prioritise transforming native institutional resources through functional optimisation rather than creating new entities. Following the principles of institutional economy, activating dormant systems outweighs establishing new regulations. Innovations must emphasise functional integration over mechanical layering, avoiding institutional redundancy while preventing functional conflicts that compromise market ecosystems. For example, in China's 2019 revision of the Securities Law, the SRL mechanism was introduced through flexible adaptation within the existing framework of the CSRC, rather than overhauling the collective litigation system based on the U.S. FRCP. Similarly, in the U.K., discussions around causes of action are shaped by the securities market structure—where institutional investors dominate—and the need to maintain issuer attractiveness. As a result, British reforms reflect a critical rethinking of U.S.-style rules rather than a wholesale transplantation. In the U.S., when addressing frivolous litigation through legislative reforms, policymakers must account for the entrenched role of class actions. Rather than abruptly shifting authority to the SEC, reforms should focus on calibrating—not eliminating—private enforcement to maintain a balanced enforcement ecosystem.

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