Corporate Scandals and Law Reforms in China

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Abstract

Since the establishment of the Shanghai and Shenzhen Stock Exchanges in 1990, China's capital market has grown into the second-largest globally by market capitalization. Despite early characterizations as a speculative "casino," empirical research now demonstrates that Chinese stock prices possess informational efficiency comparable to that of the US market. However, a core institutional paradox persists: while the market has developed effective pricing capabilities, it consistently lacks sufficient disciplinary capacity to deter corporate fraud orchestrated by controlling shareholders. This governance gap is exacerbated by weak minority shareholder protections and historical legislative ambiguities, including the belated codification of "shadow director" liability in the 2023 Company Law revision. This chapter examines this paradox through three landmark corporate scandal cases - Kangmei Pharmaceutical, Xintai Electric, and Zhangzidao, each representing a distinct evolutionary pathway in China's regulatory response. These cases illustrate major legal reforms on independent directors, advance compensation, "opt-out" securities class action, delisting reform, and technology-driven enforcement. The chapter concludes that the concentrated shareholding structure remains the primary driver of corporate misconduct, and that China's unique retail-investor-dominated market necessitates regulatory approaches distinct from Western models, with further reforms needed to address persistent agency problem.

Keywords: Corporate scandals, securities representative litigation, delisting reform, advance compensation, technology-driven enforcement

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Since the establishment of the Shanghai and Shenzhen Stock Exchanges in 1990, China's capital market has grown into the second-largest globally by market capitalization. Despite early characterizations as a speculative "casino," empirical research now demonstrates that Chinese stock prices possess informational efficiency comparable to that of the US market. However, a core institutional paradox persists:

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while the market has developed effective pricing capabilities, it consistently lacks sufficient disciplinary capacity to deter corporate fraud orchestrated by controlling shareholders. This governance gap is exacerbated by weak minority shareholder protections and historical legislative ambiguities, including the belated codification of "shadow director" liability in the 2023 Company Law revision. This chapter examines this paradox through three landmark corporate scandal cases - Kangmei Pharmaceutical, Xintai Electric, and Zhangzidao, each representing a distinct evolutionary pathway in China's regulatory response. These cases illustrate major legal reforms on independent directors, advance compensation, “opt-out” securities class action, delisting reform, and technology-driven enforcement. The chapter concludes that the concentrated shareholding structure remains the primary driver of corporate misconduct, and that China’s unique retail-investor-dominated market necessitates regulatory approaches distinct from Western models, with further reforms needed to address persistent agency problem.

I. Introduction

Marked by the successive openings of the Shanghai Stock Exchange and the Shenzhen Stock Exchange in 1990, China’s capital market has experienced rapid growth.[1] However, for a long period, this market bore distinct characteristics of a transitional economy. Until 2005, only about one-third of shares in the stock market were freely tradable, while the remainder were long held by the state or state-controlled entities. The total market capitalization did not surpass $1 trillion until 2006.[2] As early as 2001, the Chinese stock market was labeled with the famous "Casino Theory" and was viewed as a venue rife with speculation and lacking fundamental support.[3] The reason this perception became deeply ingrained for so long lies in the unique dual structural characteristics of China's capital market. This structure features a highly concentrated shareholding structure at the top and a massive retail investor base at the bottom.

However, the evolution of the Chinese market over the past two decades no longer fits the simple "casino" narrative. According to the OECD, the Chinese stock market, primarily comprising the Shanghai and Shenzhen stock exchanges, reached a total market capitalization of USD 13 trillion by the end of 2024.[4] This figure is double the size of the Japanese market, thereby solidifying China’s position as the leader in Asia and maintaining its status as the second-largest capital market globally.[5] More

[1] For scholarship on the development of China's capital market, see Franklin Allen, Jun Qian and Xian Gu, 'An Overview of China's Financial System' (2017) 9 Annual Review of Financial Economics 191; Jennifer N Carpenter and Robert F Whitelaw, 'The Development of China's Stock Market and Stakes for the Global Economy' (2017) 9 Annual Review of Financial Economics 233; Zheng Michael Song and Wei Xiong, 'Risks in China's Financial System' (2018) 10 Annual Review of Financial Economics 261; Robin Hui Huang, 'The Regulation of Securities Offerings in China: Reconsidering the Merit Review Element in Light of the Global Financial Crisis' (2011) 41 Hong Kong Law Journal 261; Robin Hui Huang, 'Private Enforcement of Securities Law in China: A Ten-Year Retrospective and Empirical Assessment' (2013) 61(4) The American Journal of Comparative Law 757.
[2] Carpenter and Whitelaw (n 1).
[3] Ibid.
[4] OECD, Asia Capital Markets Report 2025 (OECD Capital Market Series, OECD Publishing 2025) 27.
[5] Ibid.

importantly, empirical research indicates that, contrary to common perception, the predictive power of Chinese stock prices regarding future corporate earnings is comparable to that of US stock prices. The authors find that the increase in stock price informativeness coincides with improved investment efficiency in private enterprises, suggesting that the market is integrating information and providing useful signals to managers.[6] Thus, contrary to the "casino theory", the evidence suggests that the high prevalence of retail investors does not preclude the effective aggregation of information into stock prices.[7]

Nevertheless, a core institutional paradox remains. While China's capital market has acquired relatively effective pricing capabilities, it consistently lacks sufficient disciplinary capacity. Although the market can punish risk through falling prices, scandals involving financial fraud and embezzlement orchestrated by controlling shareholders still occur frequently.

Beyond the internal causes of market structure, specific regulatory and legislative loopholes have further fueled such corporate misconduct. Historically, minority shareholder protection in China has been weak. For instance, the statutory threshold for initiating a shareholder derivative suit in a joint-stock company rigidly requires holding at least 1% of the shares for 180 consecutive days.[8] This requirement remains consistently higher than in other major capital markets and severely hindered collective action by dispersed investors. Furthermore, the legal liability of "actual controllers" has long been ambiguous. It was not until the revision of the Chinese Company Law in 2023 that the equivalent concept of "shadow directors" was formally codified. This clarified the direct liability of actual controllers in an attempt to close this loophole.

This phenomenon forces us to re-examine a fundamental question of legal design. In a capital market structure dominated by controlling shareholders, should the burden of governance rely primarily on public enforcement and administrative penalties under the Securities Law? Or should it return more to civil liability and internal checks and balances under the Company Law? Or is it precisely the failure of coordination between these two laws that prevents market signals from translating into substantive governance deterrence? While falling prices cause wealth loss for controllers, without strict accompanying legal liability, such market punishment is often insufficient to curb the impulse to profit through fraud.

To answer this question, this chapter selects three representative corporate scandal cases for in-depth analysis: Kangmei Pharmaceutical Co., Ltd. (Kangmei), Dandong Xintai Electric Co., Ltd. (Xintai Electric), and Zhangzidao Group Co., Ltd.

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[6] Jennifer N Carpenter, Lu Fangzhou and Robert F Whitelaw, 'The Real Value of China's Stock Market' (2021) 139 Journal of Financial Economics 679.

[7] Ibid.

[8] Company Law of the People's Republic of China (2023 Revision) (revised by the Standing Committee of the National People's Congress on 29 December 2023, effective 1 July 2024) ('Company Law 2023'), art 189.

(Zhangzidao). The commonality among these three cases is that they are all typical samples where controlling shareholders utilized their control advantages for self-interest to orchestrate serious financial fraud and damage the interests of minority shareholders. However, beyond this commonality, the key reason for selecting them is that they respectively represent the evolution of three different pathways in the Chinese regulatory system to address the aforementioned "governance gap". The Xintai Electric case established the system of advance compensation by sponsoring institutions.[9] It exposed loopholes under the approval-based system and promoted the reform of the delisting mechanism, which solved the market "exit" problem. The Kangmei Pharmaceutical case marked the improvement of the independent director system and the shift towards a special representative litigation mechanism, or class action, which realized the substantivization of civil compensation. Finally, the Zhangzidao case demonstrated how to utilize "Regulatory Technology" (RegTech) to break through enforcement bottlenecks when facing complex fraud.

This chapter sequentially outlines the factual backgrounds and legal consequences of these cases, examines their contributing factors, and evaluates how they propelled key developments, including securities representative litigation, delisting rules, and technology-driven enforcement measures. The chapter concludes that first, the concentrated shareholding structure leading to the presence of controlling shareholders remains the primary cause of corporate scandals in China. Second, due to the inexperience and unsophistication of the retail investor base, its distinctiveness dictates that regulatory approaches must differ from Western models. And third, although the scale of the Chinese market and the importance of price information for private enterprises are increasingly significant, further reforms are still needed to address the persistent agency conflicts inherent in its structure dominated by controlling shareholders.

II. Case Summary Kangmei Pharmaceutical, Xintai and Zhangzidao

1) Kangmei Pharmaceutical

The first case this chapter would like to highlight is was the case of Kangmei Pharmaceutical. This was the largest financial fraud in the A-share market since the founding of the People's Republic of China, with Kangmei Pharmaceutical cumulatively overstating monetary funds by RMB 88.6 billion.[10] Beyond the issuer, five then-serving independent directors were held jointly and severally liable, which triggered broader resignations and reset expectations for board oversight and personal accountability.[11] Moreover, it was the first case under the new Chinese Securities

9 For an explanation of the advance compensation system, see nn 155–156.

10 CSRC, 'Decision on Administrative Penalties against Kangmei Pharmaceutical Co, Ltd, Ma Xingtian, Xu Dongjin and 22 Other Responsible Persons' (13 May 2020) [2020] No 24.

11 Liu Junhai, 'Reflection and Reconstruction of the Independent Director System of Listed Companies: Legal Thinking on the Huge Joint and Several Liability of Independent Directors in the Kangmei Pharmaceutical Case' (2022) 3 Law Science Magazine 1.

Law's special representative mechanism.[12] It was the also largest false-statement civil case by both number of plaintiffs and total compensation of RMB 2.459 billion for investors.[13]

Kangmei Pharmaceutical, a manufacturer and distributor of Traditional Chinese Medicine decoction pieces, went public in 2001 and, by 2018, ranked among the top five A-share pharmaceutical companies by revenue.[14] However, in the second half of 2018, numerous self-media articles questioned Kangmei's anomalous "high deposits and high loans" pattern, simultaneously maintaining large balances of monetary funds and interest-bearing liabilities.[15] Meanwhile, Wang Lianjun, the legal representative[16] of Boyi Investment, a related party effectively controlled by Chairman Ma Xingtian and his wife, was subjected to coercive measures by public security authorities on suspicion of stock price manipulation and insider trading. As these events unfolded, Kangmei's share price fell by the daily limit for three consecutive trading days beginning 16 October 2018.[17]

In response, the China Securities Regulatory Commission (CSRC) issued a Notice of Investigation to Kangmei Pharmaceutical in December 2018. Subsequently, the company released an Announcement on the Correction of Prior Accounting Errors on 29 April 2019, acknowledging multiple errors in its 2017 financial statements. The following day, Chairman Ma Xingtian conceded in an open letter to shareholders that the company faced deficiencies in governance, internal control, financial management, and information disclosure, while asserting that "accounting errors are different from financial fraud."[18]

After further inquiry, the CSRC found that Kangmei Pharmaceutical had engaged in extensive and sustained accounting fraud between 2016 and 2018.[19] The company made false statements and material omissions in its annual and semi-annual reports, inflating cash holdings by up to RMB 88.681 billion.[20] These funds were diverted to unlawful uses, including repaying the principal and interest of the controlling

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[12] Su Jiede, 'The First Case of Chinese-style Class Action: How High is the Cost of Fraud?' *China Newsweek* (3 May 2021).
[13] Wang Ying 'Kangmei Case Judgment: Compensation of 2.459 Billion to Investors, Accountants Bear 100% Joint Liability' *Caijing* (15 November 2021).
[14] Zhang Jianfeng, Wang Ying and Zhao Tianyu, 'Who Helped Kangmei Pharmaceutical Pull the Wool Over Everyone's Eyes?' *Caijing Magazine* (15 May 2019).
[15] Li Yunqi, 'Three Consecutive Years of Financial Fraud: Who Once Sat as the Banker of Kangmei Pharmaceutical?' *The Beijing News* (Beijing, 20 May 2019).
[16] Each company in China is required to designate a legal representative. According to Company Law 2023, art 10, the legal representative must be a director or manager who executes corporate affairs. A resignation from such a substantive position is deemed a simultaneous resignation as the legal representative, and the company is required to appoint a successor within thirty days. Furthermore, Article 11 stipulates that the company bears the legal consequences of civil activities undertaken by the legal representative in its name.
[17] *Lishi Business Review*, 'How Kangmei Pharmaceutical Collapsed: Fraud, Bribery and Pyramid Selling—No Means Left Unused' *Sina Finance* (27 May 2020) https://finance.sina.com.cn/chanjing/gsnews/2020-05-27/doc-iircuyvi5209701.shtml accessed 20 January 2026.
[18] Zhang Jianfeng, Wang Ying and Zhao Tianyu (n 14).
[19] CSRC (n 10).
[20] CSRC (n 10).

shareholder's private financing, releasing stock pledges, and paying acquisition premiums. Moreover, portions of the funds were routed through multiple related entities and used to trade Kangmei's own shares, thereby manipulating its stock price and trading volume.[21]

Consequently, on 13 May 2020, the CSRC imposed administrative penalties on Kangmei Pharmaceutical and responsible persons, including the actual controller, Ma Xingtian, and his wife, ordering corrective measures, issuing warnings, and levying fines.[22] Thereafter, on 10 July 2020, the CSRC Guangdong Bureau imposed regulatory measures on GF Securities Co Ltd in relation to its failure to exercise due care in several investment banking sponsorship and bond underwriting projects connected with Kangmei Pharmaceutical. The measures included an order for rectification, a six-month suspension of GF Securities' qualification as a sponsoring institution, a 12-month refusal to accept documents submitted by GF Securities in relation to bond underwriting business, and restrictions on the remuneration rights of two senior managers then responsible for the relevant investment banking business.[23] Subsequently, the CSRC penalized Guangdong Zhengzhong Zhujiang Accounting Firm, confiscating RMB 14.25 million in unlawful income and imposing a fine of RMB 42.75 million.[24]

Criminal accountability followed. On 12 November 2021, Ma Xingtian was sentenced to 12 years' imprisonment and fined RMB 1.2 million for market manipulation, fraudulent securities issuance, and corporate bribery. His wife, Xu Dongjin, former Vice Chairman, together with ten other individuals, received prison sentences and fines for related securities offenses.[25]

Civil liabilities were likewise imposed. The Guangzhou Intermediate People's Court ordered Kangmei Pharmaceutical to compensate 52,037 investors a total of RMB 2.459 billion. Ma Xingtian and five other principal individuals were held jointly and severally liable for the full amount, while thirteen additional directors, supervisors, and senior executives bore joint and several liability for 20%, 10%, or 5% according to fault. The auditor, Zhengzhong Zhujiang, and its signing accountants were also held jointly and severally liable for the full amount.[26]

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[21] Supreme People's Court, Supreme People's Procuratorate, Ministry of Public Security and China Securities Regulatory Commission, 'Typical Cases of Strictly Cracking Down on Securities Crimes in Accordance with the Law: The Case of Ma Xingtian et al. for Illegal Disclosure, Non-Disclosure of Important Information, and Manipulation of the Securities Market' (9 September 2022)
[22] CSRC (n 10).
[23] CSRC Guangdong Bureau, 'Decision on Imposing Regulatory Measures on GF Securities Co Ltd, Including an Order for Rectification, Restrictions on Business Activities, and Restrictions on Senior Management Rights' (20 July 2020) [2020] No 97.
[24] CSRC, 'Decision on Administrative Penalties against Guangdong Zhengzhong Zhujiang Accounting Firm, Yang Wenwei, Zhang Jingli, Liu Qing and Su Chuangsheng' (18 February 2021) [2021] No 11.
[25] Supreme People's Court and others (n 21).
[26] *Gu Huajun et al v Kangmei Pharmaceutical Co, Ltd et al* (Guangzhou Intermediate People's Court, 12 November 2021) Civil Judgment (2020) Yue 01 Min Chu No 2171.

Finally, due to insolvency, Kangmei Pharmaceutical entered court-supervised bankruptcy reorganization in June 2021. The reorganization plan was approved and fully implemented by December 29, 2021, with all creditors repaid in full.[27] Taken together, the case shows how corporate governance failures, weak intermediary oversight, and market misconduct can reinforce one another. It also shows how China's integrated enforcement across administrative, criminal, civil, and insolvency, works to deter fraud and restore investor confidence in the capital market.

2) Xintai Electric

The second case is about Dandong Xintai Electric Co., Ltd. (Xintai Electric). This case is significant as it marks the first mandatory delisting in China's A-share market for fraudulent issuance.

Xintai Electric has been struggling to meet listing standards and was initially rejected in 2009 for lacking sustainable profitability. Rather than improving fundamentals, the company pursued listing through manipulation and fraud. The company changed its sponsoring institution to Industrial Securities Co., Ltd. (Industrial Securities). Meanwhile, under mounting operational pressure, Xintai Electric relaxed client credit controls, which in turn led to a rise in accounts with poor repayment capacity. As a result, its cash flow turned negative, and simulated year-end 2011 financials reflected negative operating cash flow and a large balance of accounts receivable, both of which are critical indicators for listing eligibility.[28]

Against this backdrop, the Chief Accountant, Liu Mingsheng, concluded that the prevailing financial data would not meet listing requirements and suggested fabricating the recovery of accounts receivable.[29] Consequently, the actual controller, Wen Deyi, borrowed funds externally and instructed cashiers to withdraw and then redeposit cash under client names to create the appearance of receivables recovery. After each reporting period ended, these funds were returned to the original lenders through reverse transactions. Subsequently, to reduce borrowing costs and sustain the scheme, the company resorted to falsely endorsed bank drafts to circulate funds, as well as the direct forgery of bank deposit slips, payment slips, and bank statements. It even carved counterfeit client seals or leveraged banking connections to apply bank seals retroactively. To evade audit and regulatory scrutiny, these fabricated repayments were deliberately dispersed among multiple real clients, typically in irregular amounts to

[27] Guangdong Higher People's Court, 'Typical Cases of Bankruptcy Trials by Guangdong Courts Serving and Safeguarding High-Quality Development' (20 September 2023) https://www.gzcourt.gov.cn/yqfkdt/ck596/2023/09/20093146690.html accessed 5 January 2026.
[28] Wei Guyao, 'The Case of Xintai Electric's Fraudulent Issuance and Illegal Information Disclosure' (August 2017) 23 Law and New Finance.
[29] Wei Guyao (n 28).

simulate randomness, and were semi-integrated into genuine transaction backgrounds.[30]

Despite these deficiencies, Xintai obtained CSRC approval and listed on ChiNext in 2014,[31] not by genuine compliance but by contrived financial presentation. Not long after the listing, the CSRC initiated a formal investigation on the company, which ultimately issued an Administrative Penalty Decision concluding that Xintai Electric had engaged in fraudulent issuance and false statements during the issuance and listing process.[32] Following the CSRC's administrative penalty decision, the Shenzhen Stock Exchange initiated mandatory delisting procedures, making Xintai Electric the first A-share listed company to be mandatorily delisted for fraudulent issuance.[33] Correspondingly, the CSRC imposed individual penalties on Wen Deyi, including a warning and fines totaling RMB 900,000 (comprising RMB 300,000 as the directly responsible supervisor and RMB 600,000 as the actual controller).[34]

In parallel, the CSRC sanctioned relevant intermediaries, including Industrial Securities, the sponsoring institution, and Beijing Xinghua Certified Public Accountants, the auditing firm. Subsequently, Industrial Securities voluntarily established a special compensation fund of RMB 550 million to provide advance compensation (xianxing peifu) to eligible investors who suffered losses arising from Xintai Electric's misconduct.

3) Zhangzidao

The third case shows how Zhangzidao invoked environmental anomalies to conceal financial misreporting and internal control failures, as well as how regulators used high-tech methods such as satellite positioning and computational analysis to reconstruct actual scallop harvest and aquaculture data, ultimately confirming that the company had engaged in financial fraud.

Zhangzidao Corp., once a leading enterprise in China's aquaculture sector, leveraged the natural resource advantages of the Northern Yellow Sea Cold Water Mass and, for

[30] 'Xintai Electric Mandatorily Delisted: How Did It "Seek Its Own Death" Step by Step?' *China Fund News* (9 July 2016).
[31] Wei Guyao (n 28).
[32] CSRC, 'Decision on Administrative Penalties against Dandong Xintai Electric Co, Ltd, Wen Deyi, Liu Mingsheng and 18 Other Responsible Persons' (5 July 2016) [2016] No 84.
[33] Chai Hua, 'Xintai Electric Starts Delisting Procedures and Resumes Trading Today, Li Daxiao Cries Out: Do Not Bet on Its Rebirth' CNR (12 July 2016) [https://china.cnr.cn/yaowen/20160712/t20160712_522653542.shtml](https://www.google.com/search?q=https://china.cnr.cn/yaowen/20160712/t20160712_522653542.shtml) accessed 15 January 2026.
[34] CSRC (n 32).

a time, attained blue-chip status[35] in China's capital market.[36] However, in October 2014, the company announced that its bottom-sown Yesso scallops from 2011 and 2012 suffered near-total harvest failure due to cold-water mass anomalies, resulting in losses of RMB 1.189 billion.[37] Subsequently, the company repeatedly attributed operational difficulties to environmental factors[38] and, in January 2018, claimed that reduced precipitation and abnormal water temperatures caused scallop stocks to perish from starvation.[39]

As these explanations recurred whenever the company faced losses, public skepticism mounted, with commentators dubbing the phenomenon the "Scallop Escape Incident,"[40] which in turn prompted regulatory scrutiny. Accordingly, the company was investigated by CSRC for suspected information disclosure violations in 2018[41] and was issued an Advance Notice of Administrative Penalties and Market Ban, indicating preliminary findings of financial fraud, major internal control defects, and false records in disclosed documents in 2019.[42] However, shortly after this notice, the company again announced "massive natural death" of bottom-sown Yesso scallops within a short period, with an estimated loss of RMB 278 million.[43]

Following comprehensive investigation, the CSRC issued a formal Decision on Administrative Penalty, concluding that Zhangzidao Corp. had material internal control deficiencies and had made material misstatements in its annual reports. The investigation revealed a dual strategy of manipulation: in 2016, the company inflated profits by RMB 131 million, representing 158.11% of reported income, in order to maintain listing status; conversely, in 2017, it understated profits by RMB 278 million, representing 38.57% of reported figures, likely to manage future earnings expectations.[44] Furthermore, the company's announcements concerning inspection

[35] The term 'blue chip' denotes stocks of large, well-established corporations with a dominant market presence and high brand recognition. Distinguished by their sound financial standing and steady profitability, these entities maintain a history of strong performance and attractive dividend payouts.

[36] 'Litigation and Arbitration Cases Exceed Ten Million Yuan, Is the "First Stock of Aquatic Products" in Trouble Again?' *The Paper* (21 January 2025) https://www.thepaper.cn/newsDetail_forward_29985467 accessed 2 January 2026.

[37] Guo Zhiqiang, 'The Scallops Can't Run Away This Time: Zhangzidao Fraud Can't Escape BeiDou Satellite "Sky Eye"' *China Economic Weekly* (15 July 2020) https://paper.people.com.cn/zgjjzk/html/2020-07/15/content_1999303.htm accessed 5 January 2026.

[38] Guo Zhiqiang (n 37).

[39] Guo Zhiqiang (n 37).

[40] 'Reporters Board Zhangzidao Fishing Boat: How Many Scallops Are Left After "Collective Sudden Death"?' *CCTV Finance* (17 November 2019) https://xinwen.bjd.com.cn/content/s5dd0fedbe4b0ab28c839948b.html accessed 5 January 2026.

[41] Zhang Jing, 'Zhangzidao: Under Investigation by CSRC for Suspected Illegal Information Disclosure' *The Paper* (11 June 2019) https://www.thepaper.cn/newsDetail_forward_3653108 accessed 5 January 2026.

[42] Zhangzidao Group Co Ltd, 'Announcement on Receipt of Advance Notice of Administrative Penalty and Market Ban from CSRC' (11 July 2019) https://static.cninfo.com.cn/finalpage/2019-07-11/1206438768.PDF accessed 5 January 2026.

[43] Guo Zhiqiang (n 37).

[44] CSRC, 'Decision on Administrative Penalties against Zhangzidao Group Co, Ltd and 16 Responsible Persons' ([2020] No 29, 15 June 2020).

results, year-end inventory, and asset write-offs were determined to contain fabricated data.[45]

In light of these violations, the CSRC issued a warning to the company and imposed a fine of RMB 600,000. Additionally, fines ranging from RMB 30,000 to RMB 300,000 were levied on 15 responsible individuals, with the company's actual controller, Wu Hougang, fined RMB 300,000.[46] Thereafter, the Dalian Intermediate People's Court rendered a criminal judgment: defendant Wu Hougang was sentenced to a combined fixed-term imprisonment of fifteen years and fined RMB 920,000 for multiple crimes, including the illicit disclosure of important information, fraud, collusive tendering, and bribery to non-state functionaries. Upon appeal, the Liaoning Provincial High People's Court issued a second-instance ruling, rejecting the appeal and upholding the original judgment.[47]

III. Recurring Themes in Chinese Corporate Scandals

The interaction between these three cases and the broader trajectory of regulatory reform is not always linear. Some reforms preceded the cases and were first tested through them. Others were precipitated by the cases themselves. To more clearly illustrate this two-way relationship between landmark corporate scandals and the legal reforms they triggered or first applied, the timeline in Figure 1 visualizes the cases and reforms along parallel tracks. It reveals two patterns of influence: Xintai and Kangmei were the first practical applications of reforms enacted shortly before them, while Zhangzidao precipitated a new enforcement paradigm centered on Regulatory Technology (RegTech).

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45 CSRC (n 44).
46 CSRC (n 44).
47 'Supreme People's Procuratorate Discusses "Zhangzidao Illegal Disclosure of Important Information Case": Digging Deep into Clues of Related Crimes and Comprehensively Punishing Illegal Crimes Involving Listed Companies' *Securities Times* (21 February 2024) https://www.stcn.com/article/detail/1124850.html accessed 5 January 2026.

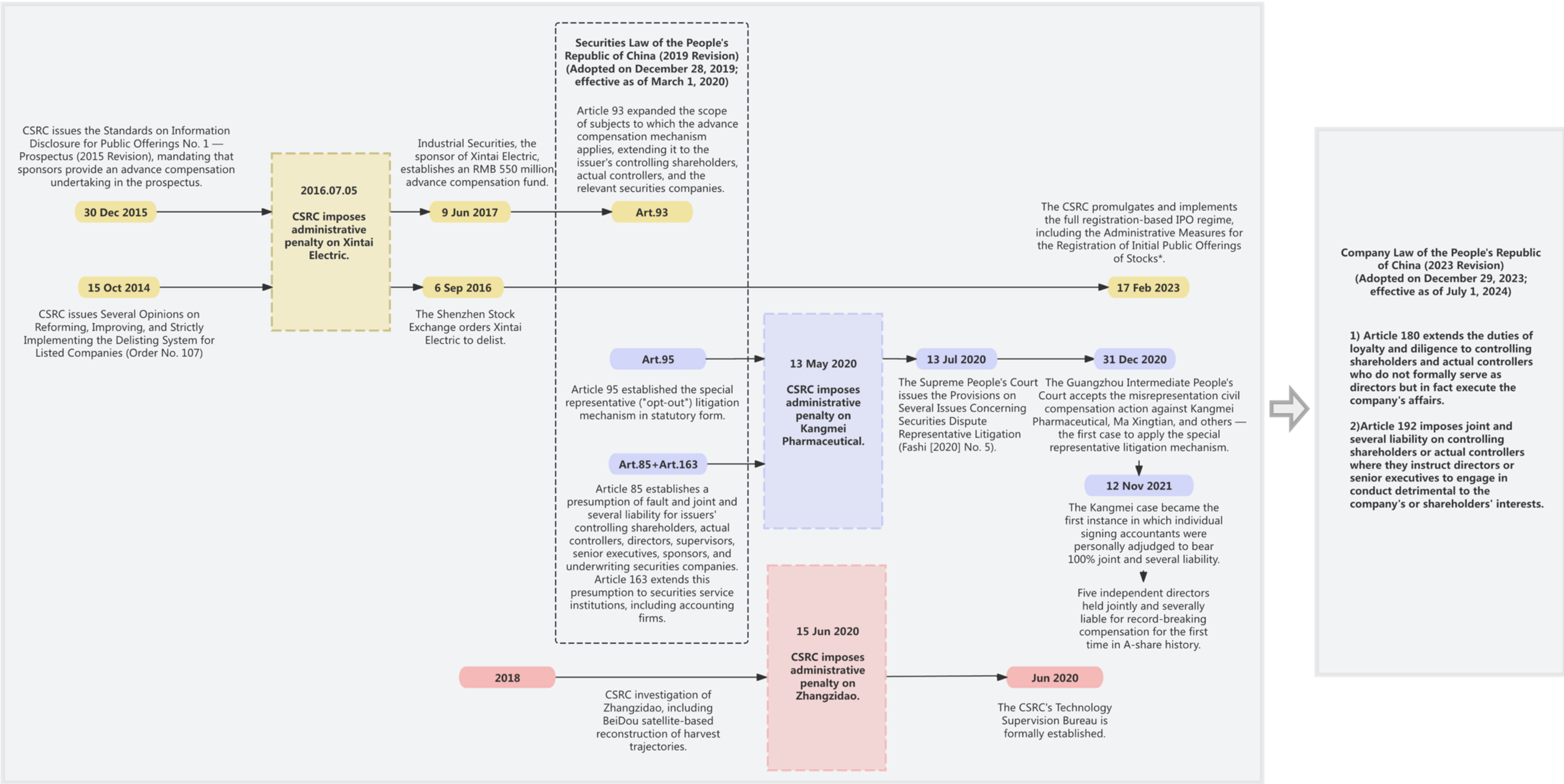

Figure 1: Timeline of Landmark Cases and Regulatory Reform in China's Capital Market (2014–2024)

1) Dominance and Abuse of Actual Controllers under Concentrated Ownership

China's capital market is characterized by a highly concentrated ownership structure. Under the 2023 Company Law, a "controlling shareholder" is defined as a shareholder whose capital contribution or shareholding exceeds 50 percent, or whose voting rights are sufficient to significantly influence resolutions of the shareholders' meeting even if their holding is below 50 percent.[48] Closely overlapping with, and often confused with the concept of a controlling shareholder, is the "actual controller",[49] defined as a person who, while not necessarily holding shares directly, is capable of actually dominating a company's behavior through investment relations, agreements, or other arrangements.[50]

Data as of January 8, 2026, illustrates this structure. Among the 5,470 A-share[51] listed companies, 5,077 have a controlling shareholder, representing 92.82% of the total. Within this group, private enterprises predominate, totaling 3,316 (accounting for 65.31% of companies with controlling shareholders), while state-backed enterprises number 1,466 (28.88%).[52]

Examining this further at the level of the actual controller, companies controlled by natural persons number 3,319, constituting 60.68% of the total A-share market, while state-owned enterprises control 1,454 companies, or 26.58%. In contrast, only 346 companies lack an actual controller, representing a mere 6.33% of the total market.[53] This extremely low figure stands in sharp contrast to developed markets, where dispersed ownership is common.

This extreme concentration of equity is not accidental but has deep historical and institutional roots. Initially, China's capital market was designed to alleviate financial distress for state-owned enterprises,[54] with shareholding reforms prohibiting alterations to existing state shares, thus entrenching concentrated state control.[55] As the listing regime shifted from quotas to approval-based,[56] many private firms going

48 Company Law 2023, art 265(2).
49 Yue Wanbing, 'Identification of Actual Controller in Company Law' (2024) 5 Science of Law (Journal of Northwest University of Political Science and Law) 1.
50 Company Law 2023, art 265(3).
51 The term A-shares ('RMB ordinary shares') refers to shares issued by companies in China, subscribed and traded in RMB, and listed on the Shanghai, Shenzhen, or Beijing Stock Exchange.
52 Data sourced from the iFinD database.
53 iFinD database (n 52).
54 Franklin Allen, Jun Qian and Xian Gu (n 1).
55 Ha Like, 'Liu Jipeng: The Stock Market Keeps Falling, "One Share Dominance" is the Essence' China Newsweek (5 November 2023).
56 On the evolution of China's stock issuance system see: Lin Lin, 'Venture Capital Exits and the Structure of Stock Markets in China' (2017) 12 Asian Journal of Comparative Law 1; Chen Fa and Zhao Lijun, 'The Comprehensive Implementation of the Registration-Based System of IPO Regulation in China: Practice, Progress, Problems and Prospects' (2024) 32 Asia Pacific Law Review 1.

public inherited this pattern.[57] Early administrative oversight further favored concentrated equity structures for easier targeted regulation.[58]

At the other end of the spectrum from equity concentration, the investor structure of the Chinese market presents distinct characteristics of retail domination. As of the end of 2024, the number of A-share investors reached approximately 236.2 million, with about 235.7 million natural person investors and 548,000 non-natural person investors.[59] The retail-dominated nature of China's stock market stems from the combined effects of early institutional design (such as the focus on SOE financing and the split-share structure), a long-term shortage of institutional capital, specific trading rules (such as the "T+1" mechanism, price limits, and restrictions on short selling), and a unique information environment.[60]

In a market environment characterized by retail dominance, the essential function of relatively constrained institutional investors diverges from the stewardship role typically seen in dispersed ownership markets. Instead, they are charged with the distinct mandate of monitoring actual controllers.[61] However, the unique shareholding structure and investor composition of China's capital market significantly weaken the influence of institutional investors compared to their counterparts in the United States (US) and the United Kingdom (UK). Consequently, the efficacy of these governance functions and the sustainability of shareholder activism remain subject to considerable skepticism.[62]

It is against this institutional background that the second type of agency problem becomes central to Chinese corporate governance. This concentrated shareholding structure has led to serious horizontal agency problems, namely profound conflicts of interest between internal controllers and external investors.[63] Unlike the classic Type I agency problem which presupposes a high degree of separation between ownership and control and centres on the conflict between shareholders and management, the Type II agency problem arises primarily in markets characterized by relatively concentrated

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[57] Ha Like (n 55).
[58] Zhong Jiyin, 'The Mystery of Chinese Companies' “Passion” for One Share Dominance' Board of Directors (12 August 2019).
[59] Data sourced from China Securities Depository and Clearing Corporation, *Statistical Yearbook 2024* (2025) 6.
[60] Carpenter and Whitelaw (n 2).
[61] For an analysis of the causes of the lack of stewardship in China, see Dan W Puchniak, 'The False Hope of Stewardship in the Context of Controlling Shareholders: Making Sense Out of the Global Transplant of a Legal Misfit' (2024) 72 The American Journal of Comparative Law 29.
[62] Lin Lin and Dan W Puchniak, 'Institutional Investors in China: Corporate Governance and Policy Channeling in the Market within the State' (2022) 35(1) Columbia Journal of Asian Law 74.
[63] While the primary governance challenge in dispersed ownership structures (common in the US/UK) is the 'vertical' conflict between managers and shareholders, China’s concentrated ownership structure gives rise to a 'horizontal' conflict between controlling and minority shareholders. See Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (3rd edn, Oxford University Press 2017) 29-30; Jiang Fuxiu and Kenneth A Kim, 'Corporate Governance in China: A Modern Perspective' (2020) 60 Journal of Corporate Finance 101506.

ownership structures.[64] In such markets, controlling shareholders wield effective decision-making power over the company, giving them both the incentive and the capacity to exploit their position to extract private benefits of control. This, in turn, exposes minority shareholders, who are inherently disadvantaged in terms of information and influence, to the risk of having their interests undermined.[65]

This horizontal agency problem can be further amplified by the divergence between cash flow rights and control rights. Cash flow rights denote a shareholder's economic entitlement to the company's residual profits in proportion to their shareholding, whereas control rights refer to a shareholder's effective power over key corporate matters, including the appointment and removal of directors, asset allocation, financing arrangements, and information disclosure. Under a straightforward one-share-one-vote structure, these two sets of rights are generally aligned: those who control the company also bear the economic consequences of any decline in corporate value in proportion to their stake. In practice, however, through mechanisms such as pyramidal shareholding structures, cross-shareholdings, acting-in-concert arrangements, voting right entrustments, contractual control arrangements, nominee shareholding by related parties, or other forms of indirect control, an ultimate controller may acquire a degree of corporate dominance that far exceeds their proportionate economic interest, on the basis of a relatively modest capital commitment.[66]

Once control rights exceed cash flow rights, the controller's incentive structure fundamentally shifts.[67] The controller can direct the allocation of corporate resources yet does not necessarily bear the full economic consequences of flawed decisions or the diversion of value. When corporate value is impaired, losses are borne by all shareholders in proportion to their respective holdings. The special benefits that the controller derives from their position of dominance, however, may be enjoyed exclusively by the controller or their related parties.

This misalignment of incentives gives rise to what is known as "private benefits of control", benefits that the controller obtains by virtue of their effective dominance over the company but that are not shared among all shareholders in proportion to their holdings.[68] Such benefits encompass both non-pecuniary gains that are inherently difficult to quantify, such as preserving family control, expanding the scale of a

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64 Adolf A Berle and Gardiner C Means, *The Modern Corporation and Private Property* (Macmillan 1932) 119–25; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Corporate Ownership Around the World' (1999) 54 Journal of Finance 471, 472–74.

65 Lucian Arye Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control' (NBER Working Paper No 7203, 1999); Ronald J Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Comparative Taxonomy' (2006) 119 Harvard Law Review 1641, 1651–58.

66 Lucian Arye Bebchuk, Reinier Kraakman and George G Triantis, 'Stock Pyramids, Cross-Ownership, and Dual Class Equity: The Mechanisms and Agency Costs of Separating Control from Cash-Flow Rights' in Randall K Morck (ed), *Concentrated Corporate Ownership* (University of Chicago Press 2000) 295.

67 Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) 52 Journal of Finance 737, 758–61.

68 Alexander Dyck and Luigi Zingales, 'Private Benefits of Control: An International Comparison' (2004) 59 Journal of Finance 537, 540–43.

business group, or consolidating personal reputation , and direct economic returns. Importantly, private benefits of control are not necessarily synonymous with unlawful gains; controlling shareholders may, in certain instances, enhance overall corporate value by contributing unique resources or advancing long-term strategic objectives.[69] The critical concern arises, however, when the private benefits extracted by the controller are not shared with shareholders at large and are obtained at the expense of the listed company or its minority shareholders. At that point, control ceases to function as a governance resource and becomes an instrument of expropriation.

"Tunneling" is the concrete manifestation of such private benefit extraction in corporate practice.[70] It may take relatively straightforward forms , such as the misappropriation of corporate funds, irregular guarantees, asset transfers at below-market value, procurement at inflated prices, or inter-company lending, or it may assume more sophisticated guises, including the diversion of profits through related-party transactions, the channelling of benefits to related parties via mergers and restructurings, the dilution of the listed company's value through inequitable asset swaps, or cross-temporal wealth transfers effected through earnings management and capital manoeuvres in connection with listing.[71] The fundamental governance challenge is that many such arrangements may, on their face, bear the hallmarks of legitimate commercial transactions and do not necessarily present as overt acts of misappropriation.

To address the reality of power operating outside regulatory oversight, corporate law practices vary across jurisdictions. While all aim to regulate control, the UK and Japan typically classify influential non-executives as "shadow directors" or "de facto directors." In contrast, the US generally incorporates them within the "controlling shareholder" framework, relying primarily on external market mechanisms to discipline their behavior.[72]

China's governance approach, built upon the concept of the "actual controller", differs significantly from the UK and the US. Most notably, 2023 Company Law defines the Actual Controller broadly as "anyone who can effectively dominate the company's actions through investment relationships, agreements, or other arrangements."[73] This concept is a product of the unique realities of China's capital market. Controlling shareholders often bypass management to become the ultimate decision-makers,

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69 Ronald J Gilson and Jeffrey N Gordon, 'Controlling Controlling Shareholders' (2003) 152 University of Pennsylvania Law Review 785, 785–88.

70 Simon Johnson and others, 'Tunneling' (2000) 90 The American Economic Review 22.

71 Guohua Jiang, Charles MC Lee and Heng Yue, 'Tunneling Through Intercorporate Loans: The China Experience' (2010) 98 Journal of Financial Economics 1; Joseph PH Fan, TJ Wong and Tianyu Zhang, 'Institutions and Organizational Structure: The Case of State-Owned Corporate Pyramids' (2013) 29 Journal of Law, Economics, and Organization 1217.

72 Zhou You, 'Differentiated Practice and Institutional Expression of Identification Standards for Actual Controllers' (2024) 1 Tribune of Political Science and Law 1.

73 Company Law 2023, art 265(3).

functioning effectively as corporate insiders even without holding formal positions.[74] This structure precipitates persistent "horizontal agency costs" (conflicts between controlling and minority shareholders), a constant concern in Chinese judicial practice. The unique governance structure renders the controlling shareholder's position exceptionally secure; external investors can neither remove them for poor performance nor shake their control through hostile takeovers.[75]

Unlike the US, where external governance mechanisms such as the threat of takeovers are prevalent, such mechanisms have little effect in China due to highly concentrated ownership structures.[76] Consequently, Chinese corporate governance must rely on an alternative external mechanism: law and institutional regulation.[77] This implies that legislators may need to expand the scope of the "controlling shareholder" concept as broadly as possible. Such an expansion would ensure that law enforcement and the judiciary retain the flexibility to identify actual controllers, thereby guaranteeing "piercing" regulatory oversight of the ultimate power holders.

In the Kangmei Pharmaceutical case, Ma Xingtian served as the founder, General Manager, and Chairman of the Board, functioning as the actual controller.[78] As of 2018, Ma Xingtian directly held 0.02% of the company's shares, while Kangmei Industrial Investment Holdings Co., Ltd., the controlling shareholder of Kangmei Pharmaceutical, held a 31.91% stake.[79] Kangmei Industrial was owned by Ma Xingtian (99.68%) and his wife Xu Dongjin (0.32%). Through this arrangement, Ma and his wife acted in concert to maintain control over the listed company via the holding company.[80]

Leveraging his position as the controlling shareholder, Ma Xingtian repeatedly downgraded product quality.[81] To preserve a competitive edge, he also directed an aggressive expansion strategy that severely strained the company's liquidity, which was a contributing factor in his subsequent decision to fabricate and window-dress the company's financial statements.[82]

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74 Zhou You (n 72).
75 Fuxiu Jiang and Kenneth A Kim, 'Corporate Governance in China: A Survey' (2020) 24(4) Review of Finance 733.
76 Zhou You (n 72).
77 Fuxiu Jiang and Kenneth A Kim (n 75).
78 The listed-company governance rules in China does not prohibit the general manager from concurrently serving as the chairman of the board. See CSRC, Code of Corporate Governance for Listed Companies (CSRC Announcement [2025] No 18, issued 16 October 2025, effective 1 January 2026) ('Corporate Governance Code 2025').
79 Zhang Jianfeng, Wang Ying and Zhao Tianyu (n 14).
80 Zou Yongqin, 'ST Kangmei's 2.948 Billion Yuan "Huge Recovery": "Pie in the Sky" or "Pie in the Picture"?' *The Economic Observer* (14 March 2024) https://www.eeo.com.cn/2024/0314/644437.shtml accessed 20 January 2026.
81 Lishi Business Review (n 17).
82 Zhang Haiting, Li Zixin and Meng Shice, 'Analysis of the Means and Motivation of Kangmei Pharmaceutical's Financial Fraud—Based on GONE Theory' (2021) 15 *Modern Business* 124.

Xintai Electric had a highly concentrated ownership structure as well. The actual controller, Wen Deyi, together with his spouse, held more than 45% of the voting rights, resulting in a classic case of single-share dominance.[83]

The aforementioned cases of Kangmei Pharmaceutical and Xintai Electric illustrate typical financial fraud orchestrated by controlling shareholders in private family-owned enterprises. In such scenarios, identifying the "actual controller" presents few obstacles.

However, the case of Zhangzidao Corp presents a unique governance dilemma. Generally, academic research on Chinese corporate governance focuses on two distinct categories of controlling shareholders: State-Owned Enterprises (SOEs) and family-owned firms. SOEs are controlled by the state and must balance the often-conflicting objectives of profit generation and state policy execution. Family-owned enterprises, by contrast, focus solely on profit maximization.[84] However, the Zhangzidao case fits neither category precisely. Rooted in the specific historical context of China's collective economy and Township and Village Enterprises (TVEs),[85] this case highlights the intricate landscape of "Actual Controller" structures in practice.

Zhangzidao Corp.'s governance dilemma stems from China's collective economy and TVE history. Originating as a branch of a 1958 People's Commune, it evolved into a collectively owned enterprise, with assets nominally belonging to all island residents but operational control vested in township officials.[86]

The evolution of TVEs can be broadly divided into several historical phases. Prior to 1979, the precursors of township and village enterprises were the commune and brigade enterprises of the People's Commune era, traceable to the Great Leap Forward of 1958 and the agricultural mechanisation drive of the 1970s.[87] Between 1979 and 1993, the introduction of the household contract responsibility system in agriculture and the devolution of fiscal authority to local governments provided grassroots governments with strong incentives to support the development of TVEs. In 1984, commune and brigade enterprises were formally redesignated as township and village enterprises, and the relaxation of the policy environment enabled them to leverage relatively inexpensive land and labour to rapidly capture market share in what was then a shortage economy.[88]

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[83] Zheng Dengjin, *Corporate Governance and Case Analysis* (Posts and Telecom Press 2024) ch 1.
[84] Fuxiu Jiang and Kenneth A Kim (n 7575).
[85] TVEs refer to market-oriented public enterprises under the jurisdiction of local governments in rural China. As a pivotal transitional institution during the early reform era (1980s–1990s), they played a crucial role in driving rural industrialization through collective community ownership. For a detailed analysis, see Chang Chun and Wang Yijiang, 'The Nature of the Township-Village Enterprise' (1994) 19 Journal of Comparative Economics 434.
[86] 'The King of Zhangzidao Sentenced to 15 Years, "Scallops Ran Away" Remains a Mystery' (*Caijing Eleven,* 6 January 2024) https://finance.sina.com.cn/xwzmt/2024-01-06/doc-inaaqvku1502380.shtml accessed 5 January 2026.
[87] Xiao Donglian, 'An Analysis of the History and Mechanism Behind the "Sudden Emergence" of the Township and Village Enterprises' (2021) 5 *Studies on the Chinese Communist Party History* 46, 47–48; Jiahua Che and Yingyi Qian, 'Institutional Environment, Community Government, and Corporate Governance: Understanding China's Township-Village Enterprises' (1998) 14 *Journal of Law, Economics, & Organization* 1, 20.
[88] Xiao (n 87) 49–52, 56; Che and Qian (n 87) 8–10

After 1994, as the macroeconomic environment underwent transformation and market competition intensified, a number of TVEs began to explore restructuring through the shareholding cooperative system or the privatisation of property rights, and the role of community governments shifted accordingly.[89] During this restructuring phase, TVEs did not necessarily convert directly into enterprises controlled by private capital in the conventional sense.

More precisely, what many township collective enterprises experienced was a transfer of control from community collectives and local governments to insiders and local elites.[90] A survey of over 600 enterprises across 15 counties in Jiangsu and Zhejiang provinces found that, by 1999, more than half of all locally government-owned enterprises had been fully privatised, and that local governments almost invariably sold enterprises to insiders rather than to outside investors.[91] The "insiders" in this context were typically not external investors of the kind found in conventional capital markets, but rather individuals deeply embedded in the community, the enterprise, or the grassroots administrative apparatus, people who possessed operational experience, local standing, organisational and coordination capabilities, and extensive relationship networks.

One strand of institutional economics holds that the reason these grassroots managers (local elites) maintained a high level of managerial motivation even in the absence of equity stakes commensurate with their contributions can be attributed to the incentive mechanism of "enterprise control rights." Against a backdrop in which initial property rights contracts were lacking and assets were difficult to quantify at the individual level, managers within publicly owned enterprises were often unable to obtain adequate residual claims (cash flow rights).[92] As a substitute, they were granted the exclusive power to direct enterprise assets and to make investment and operational decisions autonomously. The conferral of de facto control rights provided insiders, in practical terms, with an avenue through which to demonstrate their managerial capabilities in the marketplace. The enterprise rewarded the manager's prior operational contributions with the continued power to command resources; as the enterprise grew in scale, so too did the volume of resources under the manager's control, thereby forming a self-reinforcing internal incentive loop.[93]

This control-rights-based incentive loop enabled TVEs to temporarily escape the constraints of the Type II agency problem. While the Type II agency framework offers

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[89] Qiu Zeqi, 'The Transformation of TVEs and the End of Local Authoritarianism' (1999) 3 Sociological Research 82, 87–90.
[90] Qiu (n 89) 89–91.
[91] Hongbin Li and Scott Rozelle, 'Insider Privatization with a Tail: The Screening Contract and Performance of Privatized Firms in Rural China' (2004) 75 Journal of Development Economics 1, 5–8.
[92] Zhou Qiren, Property Rights and Institutional Change: Empirical Research on China's Reform (Peking University Press 2004) ch 7.
[93] Zhou, Property Rights and Institutional Change (n 92).

considerable theoretical force in analysing the structural deficiencies of modern corporate ownership, the TVE experience reveals that the explanatory reach of the theory is bounded by specific historical contexts. Under particular socioeconomic conditions, where survival and expansion constituted the enterprise's overriding objectives, the de facto controller and the nominal collective shareholders maintained a high degree of alignment in their core interests. During this period, even where an individual wielded dominant power within the enterprise, horizontal agency conflicts may not have represented the principal tension in governance practice.

As these enterprises matured and sought to interface with modern capital markets, however, the institutional arrangements born of informal contracts and ambiguous property rights evolved into a significant burden. The control rights that had originally been devolved to enable agile market responsiveness gradually became entrenched in the absence of formal checks and balances. A severe disjunction emerged between the outer shell of collective ownership, a legacy of a particular historical period, and the reality of insider dominance at the enterprise's core, resulting in a pronounced misalignment between nominal controlling ownership and de facto control when subjected to the scrutiny of modern corporate governance.

The developmental trajectory of Zoneco Group exemplifies precisely this logic of control rights evolution. In the late 1990s, resource depletion from overfishing prompted Wu Hougang, then Town Mayor and General Manager, to introduce market-oriented reforms, yielding success and consolidating his authority. In 2001, aligning with policies separating government from enterprise management, he resigned his administrative role to become full-time Chairman of the restructured joint-stock company.[94]

From the perspective of shareholding structure, Zhangzidao was not a typical personal or family holding. Before the scandal, the Changhai County Zhangzidao Investment Development Center, fully owned by the town government, held about 30.76% of shares. Two collective organizations representing administrative villages held 7.21% and 6.85%, respectively, totaling nearly 45% for these collective shareholders.[95] According to the company's 2014 disclosure, the Investment Development Center was identified as the actual controller.[96] This arrangement seemed logically self-consistent: the enterprise was controlled by the collective, and profits flowed back to the Investment Center through dividends to benefit collective members.[97]

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94 'The King of Zhangzidao Sentenced to 15 Years' (n 86).

95 Yiboshuo, 'Suspense! Zhangzidao Under Investigation, the Disaster of "Poor Student" in Collective Mixed Ownership Reform' *Jiemian News* (13 February 2018) https://m.jiemian.com/article/1942611.html accessed 5 January 2026.

96 Zhangzidao Group Co Ltd, 'Announcement on the Fulfillment of Commitments by the Actual Controller, Shareholders, Related Parties and the Company' (12 February 2014).

97 Zhang Wen, 'Zhangzidao "Whistleblower Gate" Mist Has Not Cleared: Legal Representative of Controlling Party Claims Resignation, Supervisory Committee is a Mere Figurehead' National Business Daily (27 January 2016).

However, although collective shareholders held a high percentage of shares, their organizational nature was closer to administrative bodies than professional shareholders. Zhangzidao town residents, while enjoying dividend rights, lacked institutionalized channels to participate in management or monitor decisions. The "Collective Asset Supervision Committee," composed mostly of retired community members, relied on personal relationships and informal coordination, making it difficult to form strict procedural constraints. This nominal "joint control" failed to translate into effective internal checks and balances, resulting in the major shareholders being effectively absent from governance.[98]

This absence provided space for Wu Hougang to fill the control vacuum. Although limited by public information, we cannot fully reconstruct every internal mechanism of his control, a detail from 2012 reveals the extent of the issue: Wu's brother, Wu Houji, who was responsible for procurement, was reported for fraud in purchasing and seeding operations. This event directly led to the resignation of at least five directors and senior executives between March and May of that year, including general managers of key business units. This sufficiently proves that the Wu family had already penetrated the core business lines of the enterprise.[99]

In contrast to this gradually penetrating control, by 2018, Wu Hougang's personal shareholding had been diluted from an initial 10% to just 4.12%.[100] This divergence between high de facto control rights and low cash flow rights was further amplified by the passivity of collective shareholders. Such an asymmetric structure significantly reduced his incentive to maximize overall shareholder interests and instead encouraged the pursuit of private benefits.[101]

The Zhangzidao case highlights the complexity of the "Actual Controller" concept within the Chinese context. From the perspective of static shareholding structure, the Changhai County Zhangzidao Investment Development Center is clearly more easily identified as the actual controller. However, in practice, Wu Hougang was frequently referred to by the media as the de facto "Lord of the Island." Even during the first "scallop disappearance" incident, it was Wu Hougang who personally pledged to bear 100 million yuan in disaster losses.[102] Yet, the CSRC ultimately did not penalize Wu in the capacity of an actual controller.

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98 Zhang Wen (n 97).

99 'The Rise and Fall of Wu Hougang, the "Island Lord" of Zhangzidao' (*China Rural Network*, 2 November 2020) http://journal.crnews.net/ncpsczk/2020n/d20q/scht/933621_20201102032217.html accessed 20 January 2026.

100 Zheng Yuxin, 'The Whole Story of Financial Fraud of Zhangzidao, the First Stock of Aquatic Products' *The Economic Observer* (13 July 2019) https://m.21jingji.com/article/20190713/herald/654b2038f074babafa0e994c6d023cf6.html accessed 5 January 2026.

101 Bebchuk, Kraakman and Triantis (n 66).

102 'Zhangzidao Chairman's 100 Million Yuan Loss Payment to Arrive Within One Year' *Beijing Youth Daily* (18 December 2014) https://www.chinanews.com/stock/2014/12-18/6887485.shtml accessed 20 January 2026.

This comparison perhaps points to the normative purpose of China's "Actual Controller" rule. Theoretically, the rule appears to function as a catch-all provision, with its institutional value largely realized when the liability of controlling shareholders, directors, or senior executives cannot be enforced or is circumvented.[103] However, a comparison of the three cases suggests that regulatory practice may not fully reflect this intended purpose. While identifying actual controllers in Kangmei Pharmaceutical and Xintai Electric was straightforward due to concentrated ownership, the CSRC's failure to designate Wu Hougang as the actual controller in the Zhangzidao case raises certain doubts. Specifically, the regulator did not clarify how Wu could bypass the Changhai County Zhangzidao Investment Development Center, the putative actual controller and controlling shareholder, to orchestrate financial fraud. This omission arguably implies that Wu Hougang might have been, in reality, the true actual controller.

A plausible explanation might point to a form of regulatory inertia. When confronted with the institutional realities of former TVEs, regulators appear constrained by a structural reluctance to officially strip a collective entity with complex historical origins of its nominal control in favor of a natural person. This suggests that the CSRC may utilize the "Actual Controller" designation not merely as an objective legal standard, but as a pragmatic regulatory lever, applied decisively in the context of private enterprises, yet wielded with greater caution when navigating historically complex collective structures. Ultimately, the intersection of modern corporate law with historical institutional forms, such as TVEs, introduces significant complexities into the identification process, indicating that the application of the "Actual Controller" concept is shaped by a multifaceted interplay of legal, institutional, and historical variables.

a) Reform on Actual Controller

In China, the liability of actual controllers has been evolving gradually under both Securities Law and Company Law. Initially, the 1998 Chinese Securities Law adhered strictly to the principle of separate legal personality and did not impose direct liability on actual controllers toward minority investors or the company.[104] The Supreme People's Court's 2003 Provisions on Civil Compensation for False Statements then address actual-controller liability indirectly through an ambiguous "right of recourse," without expressly denying it.[105]

With the rapid development of Chinese capital markets, tunneling by actual controllers became increasingly common. However, under the 1994 Company Law, when controllers directed corporate misconduct, the company typically bore the legal consequences but not the actual controller. To address this issue, the 2005 Company

[103] Zhou You (n 72).
[104] Securities Law of the People's Republic of China 1998 (adopted by the Standing Committee of the National People's Congress on 29 December 1998, effective 1 July 1999) ('Securities Law 1998'), art 63.
[105] Supreme People's Court, Provisions on Several Issues concerning the Trial of Civil Compensation Cases Arising from False Statements in the Securities Market (Fa Shi [2003] No 2, effective 1 February 2003) ('False Statement Provisions 2003'), arts 7, 22.

Law introduced duties of controlling shareholders and the shareholder derivative action for the first time. The 2005 Securities Law also imposed *fault-based joint and several liability* on actual controllers.[106] Regrettably, the divergence between *the strict liability applied to issuers* and *the fault liability applied to controllers* meant that enforcement remained skewed toward listed companies. This effectively rendered the liability of actual controllers largely nominal.[107]

Article 85 of the 2019 Securities Law introduced *the principle of presumption of fault* on actual controllers.[108] This provision mandates that if actual controllers cannot prove they are without fault, they have to bear joint and several liability with the issuer. This rule effectively positions the actual controller as the ultimate guarantor of the listed company's conduct, as it legally presumes a causal link between the exercise of control and the illicit outcome.[109] Such approach attracted academic criticism for undermining corporate personality.[110]

Following the revision of the Securities Law, the 2023 Company Law offered a prudent corrective. Rather than blindly following the expansionist path of Securities Law, the 2023 Company Law provides a new legal basis for regulating controlling shareholders. It mandates that controlling shareholders or actual controllers who effectively execute corporate affairs are subject to the directors' duties of loyalty and diligence.[111] This new law adopted the "shadow director" approach in regulating controller's duties by identifying the subject of liability based on the actual execution of affairs.

Moreover, the 2023 Company Law strengthened minority shareholder countervailing power by lowering the shareholding threshold for interim proposal rights from three percent to one percent[112] and introducing appraisal rights, permitting minority

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[106] Securities Law of the People's Republic of China (2005 Revision) (revised by the Standing Committee of the National People's Congress on 27 October 2005, effective 1 January 2006) ('Securities Law 2005'), art 69.

[107] Zheng Yu, 'Reflection and Construction of the Legal Liability of Actual Controllers of Listed Companies' (2021) 43(2) *Chinese Journal of Law* 95, 103.

[108] Securities Law of the People's Republic of China (2019 Revision) (revised by the Standing Committee of the National People's Congress on 28 December 2019, effective 1 March 2020) ('Securities Law 2019'), art 85: 'Where an information disclosure obligor fails to disclose information in accordance with relevant regulations, or where there are false records, misleading statements, or material omissions in the securities issuance documents, periodic reports, ad hoc reports, or other information disclosure materials announced by it, which result in losses to investors in securities trading, the information disclosure obligor shall be liable for compensation. The issuer's controlling shareholder, actual controller, directors, supervisors, senior executives, and other directly responsible personnel, as well as the sponsor, the underwriting securities company, and their directly responsible personnel, shall bear joint and several liability for compensation with the issuer, unless they can prove that they are not at fault.'

[109] Lu Chenglong, 'Liability for Information Disclosure Violations Should Not be Generalized' (2023) 33 Securities Law Review 145.

[110] Critics argued that it blurs internal authority and responsibility allocations and creates perverse incentives for directors, who should bear the duty of diligence, to avoid responsibility. See Zheng Yu (n 107).

[111] Company Law 2023, art 180: "Directors, supervisors, and senior executives shall assume a duty of loyalty to the company, and shall take measures to avoid conflicts between their own interests and the interests of the company, and shall not use their powers to seek improper benefits. Directors, supervisors, and senior executives shall assume a duty of diligence to the company, and shall exercise the reasonable care usually expected of managers for the best interests of the company when performing their duties. The controlling shareholders and actual controllers of the company who do not serve as directors of the company but actually execute company affairs shall be subject to the provisions of the preceding two paragraphs."

[112] Company Law 2023, art 115(2): "Shareholders who individually or collectively hold more than one percent of the company's shares may submit interim proposals in writing to the board of directors ten days before the

shareholders to demand share repurchase at reasonable prices when controlling shareholders abuse their rights and cause serious harm.[113] Additionally, the scope of derivative action was expanded to include wholly owned subsidiaries, further enhancing supervisory mechanisms within corporate groups.[114]

Furthermore, the *Chinese Code of Corporate Governance for Listed Companies* was revised in 2025[115] to reinforce "penetrating supervision" of actual controllers. It mandates that non-director controlling shareholders bear joint and several liability if they instruct executives to act against the company's interests.[116] Additionally, when the Chair of the board also serve as General Manager (equivalent to CEO in common law context), companies must now provide a robust justification for such arrangements and implement safeguards to preserve corporate independence.[117]

In addition, in order to diversify investors and tackle the dominant shareholders problem, Chinese regulators have been progressively easing investment restrictions on both domestic and foreign institutional investors.[118] Recent initiatives, such as the

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shareholders' meeting is convened. Interim proposals shall have specific topics and specific resolution matters. The board of directors shall notify other shareholders within two days after receiving the proposal and submit the interim proposal to the shareholders' meeting for deliberation; however, interim proposals that violate the provisions of laws, administrative regulations, or the articles of association, or do not fall within the scope of the shareholders' meeting's powers are excluded. The company may not increase the shareholding ratio requirement for shareholders proposing interim proposals."

[113] Company Law 2023, art 89(3): "where the controlling shareholder of a company abuses its shareholder rights and thereby seriously harms the interests of the company or of other shareholders, the other shareholders have the right to request that the company purchase their equity interests at a reasonable price."

[114] Company Law 2023, art 189 (3): "where a director, supervisor, or senior manager of a company's wholly owned subsidiary falls within the circumstances specified in the preceding article, or where any other person infringes the lawful rights and interests of the company's wholly owned subsidiary and causes losses, the shareholders of a limited liability company, and the shareholders of a company limited by shares who, individually or in aggregate, have held at least one per cent of the company's shares for 180 consecutive days or more, may, in accordance with the preceding three paragraphs, request in writing that the board of supervisors or the board of directors of the wholly owned subsidiary bring an action before a people's court, or may directly bring an action before a people's court in their own name." For the previous implementation of shareholder derivative litigation in China, see Robin Hui Huang, 'Shareholder Derivative Litigation in China: Empirical Findings and Comparative Analysis' (2012) 27 Banking & Finance Law Review 619.

[115] The Code was revised by the China Securities Regulatory Commission and became effective on 27 March 2025.

[116] *Code of Corporate Governance for Listed Companies* 2025, art 66: "Controlling shareholders shall exercise their shareholder rights and perform their shareholder obligations in accordance with the law with respect to the listed companies they control. Controlling shareholders and actual controllers shall not abuse their control rights to damage the legitimate rights and interests of the listed company and other shareholders, and shall not use their controlling position over the listed company to seek illegal benefits. Where controlling shareholders or actual controllers of a listed company instruct directors or senior executives to engage in acts that damage the interests of the listed company or shareholders, they shall bear joint and several liability with such directors or senior executives. Controlling shareholders and actual controllers of a listed company who do not serve as directors of the company but actually execute company affairs shall assume duties of loyalty and diligence to the company."

[117] *Code of Corporate Governance for Listed Companies* 2025, art 72: "Personnel of listed companies shall be independent of controlling shareholders. Senior executives of listed companies may not hold administrative positions other than directors or supervisors in the controlling shareholder. Where senior executives of the controlling shareholder concurrently serve as directors of the listed company, they shall ensure sufficient time and energy to undertake the work of the listed company. Where the controlling shareholder or actual controller concurrently serves as the chairman and general manager of the listed company, the listed company shall reasonably determine the powers of the board of directors and the general manager, explain the rationality of such arrangement, and the measures to maintain the independence of the listed company."

[118] In fact, shareholder activism in China has been quite frequent in recent years. See: Lin and Puchniak (n 62); Zhou Chun, Zhang Wei and Dan W Puchniak, 'The Overlooked Reality of Shareholder Activism in China: Defying Western Expectations' (2025) 15 Harvard Business Law Review 521.

Shanghai-Hong Kong Connect [119] and Shenzhen-Hong Kong Stock [120] Connect programs, as well as the Qualified Foreign Institutional Investor scheme [121], have facilitated greater inflows of long-term capital into the capital markets. China has also actively attracted different types of investors, including sovereign wealth funds[122] and professional insurance institutions[123], into the A-share market.

2) Reform on Independent Director

The Kangmei Pharmaceutical case propelled the reform of China's director system, specifically prompting comprehensive changes to director nomination procedures, performance methods, compensation structures, and liability rules. It directly influenced the 2023 amendments to the *Company Law*, *the Measures for the Administration of Independent Directors of Listed Companies* [124] *(hereinafter "Independent Director Measures"), and the Provisions of the Supreme People's Court on Several Issues Concerning the Trial of Civil Compensation Cases for Misrepresentation in the Securities Market.*[125]

In the Kangmei case, five independent directors were held jointly and severally liable for up to RMB 369 million. This exceptionally severe penalty fundamentally dismantled the prevailing market perception that independent directors, sometimes described as "flower vase directors", bear little responsibility. In the past, administrative penalties against independent directors were not uncommon in the A-share market. However, civil liability on this scale for corporate fraud was unprecedented. This substantial compensation then triggered a wave of resignations by independent directors at listed companies.[126]

China's independent directors have long faced criticism for lacking genuine independence. Although originally transplanted from the US to provide external oversight of corporate decisions, the system is often compromised by the concentrated ownership structure of Chinese listed companies. [127] Furthermore, inadequate

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119 This refers to an institutional arrangement where the Shanghai Stock Exchange and the Stock Exchange of Hong Kong Limited establish a technical connection to enable investors in the mainland and Hong Kong to buy and sell stocks listed on the other's exchange within a specified range through local securities companies or brokers. See *Provisions on the Mechanism for Mutual Access to Stock Markets in the Mainland and Hong Kong*, art 2.
120 The same institutional arrangement as mentioned in the preceding note, except that the corresponding entity on the mainland side is the Shenzhen Stock Exchange.
121 Launched in 2002, the Qualified Foreign Institutional Investor (QFII) scheme is a transitional institutional arrangement that allows licensed international institutional investors to invest in China's RMB-denominated capital markets (such as A-shares) within specific regulatory quotas. It served as the first significant channel for foreign capital to access China's domestic financial markets amidst the country's strict capital account controls.
122 Li Yu, 'From 700 Million Yuan to 165.9 Billion Yuan: QFII's 20 Years in the Market' 21st Century Business Herald (27 June 2023).
123 Pang Xinyi, 'Insurance Funds "Running into the Market": Insurance-linked Private Equity "Rushing Towards" High-Quality Listed Companies' Economic Information Daily (1 July 2025).
124 Revised by the China Securities Regulatory Commission on 4 August 2023, effective 4 September 2023.
125 Revised by the Supreme People's Court on 21 January 2022, effective 22 January 2022.
126 Zhang Yuxuan, 'The Butterfly Effect of the Kangmei Case: Listed Companies Announce Resignations Overnight, Over a Hundred Directors and Supervisors Resign Urgently' *China Economic Weekly* (23 November 2021).
127 Zhang Yuxuan (n 126).

compensation fails to incentivize diligent oversight by independent directors. By late 2020, among over 14,000 independent directors in the A-share market, the majority received allowances not exceeding RMB 100,000 (approximately USD 14,000).[128] These figures are grossly disproportionate to the massive liability exposure demonstrated in the case of Kangmei.[129]

Another feature of China's independent directors is the prevalence of academics serving as independent directors.[130] Lacking sufficient time and resources to delve into operational details, these scholar-directors are often unable to address information asymmetry problem, rendering their oversight largely nominal.[131]

Post-Kangmei law reforms have substantially reshaped the role of independent directors, transforming them from “quasi-executive directors” to genuine “supervisory directors.” In 2023, regulations explicitly mandated that independent directors owe duties of loyalty and diligence to the listed company and all its shareholders.[132] Their supervisory responsibilities were rigorously refocused on monitoring material conflicts of interest involving controlling shareholders, actual controllers, and senior management.

Concurrently, Article 180, Paragraph 2 of the 2023 Company Law defined the duty of diligence at the legislative level for the first time, stipulating that “managers shall exercise the reasonable care that a manager would normally exercise for the best interests of the company.” Article 180, Paragraph 3 extends regulatory scope to situations where controlling shareholders or actual controllers execute company affairs, effectively capturing “shadow management.” Additionally, Article 193 encourages companies to purchase directors' liability insurance, balancing risk-sharing mechanisms with reinforced liability enforcement.

Notably, a focal point of controversy in the Kangmei case was the judicial failure to distinguish the diligence standards applicable to independent versus executive directors. This undifferentiated approach exposed part-time independent directors to liability commensurate with that of full-time executive directors. To address this concern, China introduced a "safe harbor" mechanism in 2022. Under this rule, directors may be exempted from liability for failing to detect irregularities "outside their specific professional field," provided they have exercised due care by seeking professional

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128 Chen Fuye, ‘After Kangmei Pharmaceutical’s Sky-High Compensation, Where Do the 14,000 “Chinese-style” Independent Directors Go?’ *Prism* (25 November 2021).
129 Chen Fuye (n 128).
130 Yang Yazhu, 'Kangmei Pharmaceutical Crime: Why Are Independent Directors Also Held Liable for 300 Million?' *TMTPost* (Beijing, 18 November 2021).
131 Hua Sheng, Cai Qian and Dong Shen, 'Where Did We Go Wrong? — Independent Directors and Corporate Governance (Part II)' *Shanghai Securities News* (Shanghai, 15 December 2021). See also Lin Lin, “Regulating Executive Compensation in China: Problems and Solutions” (2014) 32(2) Journal of Law and Commerce 207-254.
132 CSRC, Measures for the Administration of Independent Directors of Listed Companies (CSRC Order [2023] No 220, issued 1 August 2023, effective 4 September 2023), art 3.

assistance.[133] By acknowledging the objective limitations on independent directors' access to information and expertise, this provision provides a legislative basis for a differentiated duty of diligence.

3) Gatekeeper Failure, Listing Discipline, and Delisting Reform

Beyond internal governance mechanisms such as the independent director system, China's capital market also depends on external gatekeepers and market-based discipline to deter corporate fraud. These safeguards have proved similarly fragile. Intermediaries failed to screen out unfit issuers at entry, while listing and delisting rules failed to discipline them once admitted. The following discussion examines reforms addressing these twin failures, namely the consolidation of intermediary liability and the tightening of listing and delisting rules.

a) Consolidating the Liability of Intermediaries

Sponsors and auditing firms serve as critical gatekeepers against corporate financial fraud.[134] However, in instances of securities fraud within the Chinese capital market, both sponsoring institutions and auditing firms have frequently failed to fulfill their expected roles. For example, in the Kangmei Pharmaceutical case, between 2006 and 2011, Kangmei Pharmaceutical raised over RMB 6.7 billion through equity offerings, convertible bonds, and rights issues. GF Securities, acting as the sponsor, played a key role in this series of corporate financing exercises. In 2006, when GF Securities was unwinding its employee stock ownership plan in preparation for listing, Ma Xingtian, the actual controller of Kangmei Pharmaceutical, acquired the relevant shares through related parties, thereby assisting GF Securities in completing its pre-listing compliance rectification.[135]

Even while Ma Xingtian and his family were under investigation for bribery, GF Securities continued to serve as their financing service provider. Furthermore, members of the Ma family repeatedly participated deeply in multiple projects underwritten by GF Securities and, at one point, became one of its major shareholders.[136] Under such circumstances, the independence of GF Securities is open to question.

The dereliction of duty by the auditing firm was equally severe. Despite long-term anomalies in Kangmei Pharmaceutical's financial status, including over 20 major error corrections in its 2017 financial report, Zhengzhong Zhujiang, which had provided

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[133] Misrepresentation Provisions 2022, art 16.

[134] Reinier H Kraakman, 'Gatekeepers: The Anatomy of a Third-Party Enforcement Strategy' (1986) 2 Journal of Law, Economics, & Organization 53; John C Coffee Jr, 'Gatekeeper Failure and Reform: The Challenge of Fashioning Relevant Reforms' (2004) 84 Boston University Law Review 301.

[135] Zhang Kexin, 'Ma Xingtian Arrested, Is Kangmei Pharmaceutical Saved?' *Wumian Caijing* (13 July 2020).

[136] Zhang Kexin (n 135).

auditing services to the company for a long time, continued to issue" standard unqualified opinions" for over a decade, failing to identify the fraudulent activities.[137]

It is worth noting that as Kangmei Pharmaceutical's financial fraud deepened, the audit fees charged by Zhengzhong Zhujiang rose abnormally. Data indicates that prior to 2009, the annual audit fees paid by Kangmei Pharmaceutical were less than RMB 1 million. However, starting from 2010, these fees began to increase significantly, reaching RMB 5 million by 2015 and peaking at RMB 6.4 million in 2018. This surge in fees suggests that the auditing firm may have compromised its independence for economic gain.[138]

The Kangmei case illustrates a broader pattern in Chinese capital market regulation. Regulators tend to rely on severe ex-post penalties and high compensation to respond to public concerns, exposing deficiencies in ex-ante and interim supervision. This tendency is particularly evident in the regulation of financial intermediaries.[139]

The PRC *Securities Law* revised in 2019 established the principle of “presumption of fault” for financial intermediaries. This requires intermediaries to bear the burden of proving that they were not at fault; otherwise, they must bear corresponding liability for compensation.[140] The Kangmei Pharmaceutical case was the first major instance where this rule was applied. Moreover, while there had been numerous judgments in securities fraud litigation where intermediaries bore 100% joint and several liability, the Kangmei Pharmaceutical case marked the first instance where individual signing accountants were adjudged to bear 100% joint and several liability personally.[141]

b) Listing Discipline and Delisting Reform

When intermediaries fail to screen out fraudulent companies at the issuance stage, the regulatory burden shifts disproportionately to the market's exit mechanisms. Historically, however, China's delisting framework struggled to function as an effective market exit mechanism. Before China adopted a registration-based IPO system in 2023,[142] the stock market used an approval-based system in which the CSRC conducted in-depth reviews of listing applications. This made a stock exchange listing a scarce and valuable “shell resource.”[143] As a result, investors often assumed that companies approved by the CSRC had strong finances and solid growth prospects.[144]

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137 Zhang Jianfeng, Wang Ying and Zhao Tianyu (n 14).
138 Zhang Haiting, Li Zixin and Meng Shice (n 82).
139 Zhou Chun, 'Securities Issuance Misrepresentation: Identification and Reflection on Fault Liability of Intermediaries' (Issue 7, Year Unknown) Securities Market Herald 70.
140 Securities Law 2019, art 163.
141 Wang Ying (n 13).
142 CSRC, 'Rules for the Comprehensive Implementation of the Registration-Based Stock Issuance System Released and Implemented' (17 February 2023) https://www.csrc.gov.cn/csrc/c101819/c7396733/content.shtml accessed 5 January 2026.
143 Xing Huiqiang, 'The Logic Transformation and Legal Response of China's Capital Market Reform' (2019) 5 *Hebei Law Science*.
144 Lin Lin (n 56).

For issuers, securing a listing brought major benefits such as easier access to financing, greater brand credibility, and more flexibility for capital transactions.

Before the 2024 revision of the Provisions on On-Site Inspection of Initial Public Offering Enterprises (the 2024 Provisions), the CSRC mainly reviewed paperwork and conducted only a small number of on-site inspections chosen by lottery.[145] Companies selected for inspection rarely made it to market, while those not selected often raised large sums at high valuations.[146] This chance-based system encouraged firms to submit weak or incomplete applications, hoping to avoid inspection. Most would withdraw their applications if they were picked for inspection.[147]

The 2024 Provisions closed this loophole by stating that withdrawal would no longer stop an inspection, making applicants accountable for what they filed.[148] However, many companies, including Xintai Electric, had already been listed despite serious defects before the new rules took effect.

This "listing by luck" problem was made worse by how hard it was to delist companies from the A-share market. Although a delisting framework has existed since 2001 and has been revised several times, many poorly performing or non-compliant firms managed to avoid removal, becoming so-called "undying birds." Key reasons included the high market value of shell resources, which drew in local governments, financial institutions, and minority shareholders with an interest in keeping listings alive. Moreover, weak oversight by intermediaries, and financial delisting triggers that could be manipulated. Together, these factors long hindered effective delisting.[149]

Xintai was the first case where mandatory permanent delisting procedures were initiated due to fraudulent issuance following the CSRC's release of the *Several Opinions on Reforming, Improving, and Strictly Implementing the Delisting System for Listed Companies* (hereinafter "Order No. 107") in October 2014. Also, it marked the first practical instance where a securities company used its own funds to provide advance compensation to investors since the CSRC formally introduced the "advance compensation mechanism by sponsoring institutions" in 2013.[150]

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[145] Liu Yanru and Pan Xiaoli, 'Guantao Viewpoint | Practical Observation: Review and Analysis of On-Site Inspections of IPO Enterprises Since 2021' (*Guantao Law Firm*, 20 June 2024) https://www.guantao.com/page2498 accessed 5 January 2026.

[146] 'Many Experts Diagnose "Accounting Errors" to Prescribe Remedies for Listed Company Governance' *China News* (13 May 2019) https://www.chinanews.com/cj/2019/05-13/8834649.shtml accessed 5 January 2026.

[147] China News (n 146).

[148] China Securities Regulatory Commission, Provisions on On-Site Inspection of Initial Public Offering Enterprises (2024 Revision) (issued 15 March 2024, effective on issue), art 12.

[149] Liu Caiping, Zheng Lichun and Zhu Liangtao, 'The First Stock Delisted for Fraudulent Issuance' *Caixin Weekly* (10 April 2017).

[150] Wang Xu, 'Advance Compensation | An Innovative Exploration of Advance Compensation Plans in the Context of Delisting—Lessons from the Xintai Electric Advance Compensation Case' (28 November 2024) < https://mp.weixin.qq.com/s?__biz=MzUxMzAyODM4NA==&mid=2247529277&idx=3&sn=76356bdeac6ae2dc5835816eacb041c9&chksm=f8975509295696a2ffde0607523a10138189df4265ac0d101dcb69a2d04a13d70d4933983b55#rd > accessed 5 January 2026.

To address the long-standing difficulty of delisting, *Order No. 107*, promulgated in 2014, introduced a mechanism for mandatory delisting due to serious legal violations, aiming to make the delisting process more market-oriented and law-based. Prior to this, most delistings of listed companies in China were caused by failures to meet financial indicators. After the implementation of *Order No. 107*, regulators began to substantively enforce mandatory delisting for fraudulent issuance and material violations regarding information disclosure. Xintai Electric became a typical case of mandatory delisting due to serious violations under this system.[151]

However, the delisting process of Xintai Electric was quite lengthy, and the uncertainty during this period provided room for speculation by investors with high risk appetites. In fact, even after the delisting decision was clarified, the company's stock price experienced abnormal fluctuations multiple times, and it even closed at the daily limit up price on the last day of the delisting consolidation period.[152]

Subsequently, the Central Commission for Comprehensively Deepening Reform reviewed and approved a new round of delisting reform plans. The Shanghai and Shenzhen Stock Exchanges successively revised their delisting rules to optimize market exit channels and simplify delisting processes.[153] Data also indicates that a trend of normalized delisting in China's A-share market is gradually taking shape. From 2019 to 2023, the number of companies delisted from the A-share market was 10, 16, 22, 43, and 46, respectively, showing an overall upward trend year by year.[154]

4) Investor Redress through Special Representative Litigation and Advance Compensation

Beyond listing regime reforms, the cases of Xintai Electric and Kangmei Pharmaceutical, along with the emergence of their corresponding redress mechanisms, mark a progressive shift in China's regulatory framework from administrative penalties towards civil compensation to protect a vast retail investor base. The following analysis examines how these two cases have shaped the current landscape of investor redress.

c) Advance Compensation System

“Securities advance compensation” denotes an institutional mechanism whereby, in cases of serious securities market violations such as misrepresentation (particularly fraudulent issuance), parties potentially subject to joint and several liability, such as

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[151] Liu, Zheng and Zhu (n 149).

[152] Gui Haoming, 'Can Mandatory Delisting Be More Decisive?' *China Securities Journal* (27 August 2016) https://www.cs.com.cn/ssgs/gsxw/201608/t20160827_5043839.html accessed 5 January 2026.

[153] 'Explanation on the Revision of Rules including the Rules Governing the Listing of Stocks on the Shenzhen Stock Exchange (2020 Revision) and the Rules Governing the Listing of Stocks on the ChiNext Board of Shenzhen Stock Exchange (December 2020 Revision)' (*Shenzhen Stock Exchange*, 31 December 2020).

[154] 'Guangdong Enters the Era of “Normalized Delisting”: 8 Companies Mandatorily Delisted in One Year, Accelerating Capital Market Metabolism' (*Guangdong Bureau of CSRC*, 5 February 2024) https://www.csrc.gov.cn/guangdong/c105596/c7461757/content.shtml accessed 5 January 2026.

sponsoring institutions or controlling shareholders, advance funds to compensate harmed investors prior to the finalization of administrative penalties or judicial decisions. These parties subsequently pursue recourse against the issuer, listed company, or other liable entities to recover the advanced funds.[155]

The Xintai Electric case holds unique significance as the first implementation[156] of this mechanism, following the 2015 revision of the *Standards for the Contents and Formats of Information Disclosure by Companies Offering Securities to the Public No. 1 (Prospectus)*. This revision explicitly codified the advance compensation obligations of sponsoring institutions.[157] Consequently, the case prominently affirmed the distinctive and primary position of sponsors within this investor protection framework.

The pivotal role of sponsoring institutions in this mechanism stems from the historical evolution of China's sponsorship system. In 2001, the Chinese capital market transitioned to an approval-based issuance regime. Under this system, securities companies acting as lead underwriters assumed the duties of screening and recommendation, while final approval authority remained with the CSRC.[158] To manage heightened regulatory demands, the CSRC formally introduced the sponsorship system to the A-share market in 2004, drawing inspiration from international best practices. This reform reoriented the focus of oversight from individual issuers to key intermediaries, reinforcing the gatekeeper responsibilities of securities firms amidst widespread compliance deficiencies.[159]

In addition to their regulatory prominence, sponsoring institutions' robust financial resources render them “ideal defendants” in civil litigation.[160] In Xintai Electric, investor claims predominantly targeted the issuer and Industrial Securities (the sponsor),

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[155] Huang Hui and others, 'Research on Civil Compensation, Administrative Fines and Criminal Fines in the Capital Market' (2018) 4 Investor Service Research 25.

[156] Although the *Xintai Electric* case is often highlighted, it was not the first instance of advance compensation in China; it was preceded by the cases of *Wanfu Biotechnology* and *Hailianxun*. In the *Wanfu Biotechnology* case, Ping An Securities established a special fund of RMB 300 million to compensate investors affected by the misrepresentation; see Huang Hui and others (n 155) 26. However, unlike in *Xintai Electric*, the actual controller, Gong Yongfu, undertook joint liability, and his wife pledged 30 million shares to the fund manager, substantially alleviating the recourse burden on Ping An Securities; see 'The Wanfu Biotechnology Case: Testing Advance Compensation with Active Investor Rights Protection' (*CSRC*, 3 August 2015) https://www.csrc.gov.cn/csrc/c100211/c1452059/content.shtml accessed 5 January 2026. By contrast, the *Hailianxun* case represented the first instance of voluntary advance compensation initiated solely by a controlling shareholder, absent the involvement of a sponsoring institution; see 'Wanfu Biotechnology (Hunan) Agricultural Development Co Ltd Announcement on the Letter of Commitment Issued by the Controlling Shareholder' (10 May 2013) https://static.cninfo.com.cn/finalpage/2013-05-10/62480680.PDF accessed 5 January 2026.

[157] See China Securities Regulatory Commission, Standards for the Contents and Formats of Information Disclosure by Companies Offering Securities to the Public No 1 — Prospectus (2015 Revision), art 18. This article requires the front page of the prospectus to contain the following statement and undertaking: ‘The sponsor undertakes that if the documents prepared and issued by it for the issuer's initial public offering contain false records, misleading statements or material omissions, causing losses to investors, it shall compensate investors for their losses in advance.’

[158] CSRC, 'Implementation of the Securities Issuance and Listing Sponsorship System: An Important Measure to Deepen the Reform of the Issuance System' (21 December 2006) https://www.csrc.gov.cn/csrc/c101819/c1499935/content.shtml accessed 5 January 2026.

[159] Guo Li and Li Yisi, 'Analysis of the Responsibility Distribution of Intermediaries in IPOs: Starting from the Xintai Electric Case' (2017) 5 Securities Law Review 18, 22.

[160] Guo and Li (n 159).

either jointly or solely, with auditing firms rarely sued.[161] Moreover, given the vulnerability of China's numerous retail investors, owing to limited risk assessment capabilities, regulators have long prioritized investor protection.[162] These factors provide a pragmatic rationale for designating sponsoring institutions as primary subjects of advance compensation.

Nevertheless, Xintai Electric exposed flaws in the system. In contrast to the cooperative actual controllers in prior cases, Xintai Electric's delisting left the company and its controllers incapable or unwilling to contribute, compelling Industrial Securities to litigate for recourse and confront enforcement challenges.[163]

The 2019 revision of the *Securities Law* partly remedied these issues. Article 93 broadened applicable subjects to encompass issuers' controlling shareholders, actual controllers, and relevant securities companies. The 2023 Amethystum Storage case exemplified this expanded regime: four intermediaries (one securities company, two accounting firms, and one law firm) jointly funded a RMB 1 billion special advance compensation fund to redress eligible investors' losses.[164]

d) “Opt-out” Securities Class Action

The 2019 revision of the Securities Law introduced a chapter on “Investor Protection,” formally establishing a securities class action mechanism characterized by an “opt-out” feature.[165] Subsequently, the Supreme People's Court of China released judicial interpretations to further refine the operational rules of this mechanism.[166] The above Kangmei case is the first case following the implementation of this “opt-out” mechanism.[167]

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[161] Guo and Li (n 159).
[162] Huang Hui and others (n 155) 12.
[163] Meng Qiang and Zhang Jingjing, 'Determination and Assumption of Civil Liability of Intermediaries in Securities Misrepresentation Infringement Cases' (2023) 2 *Economic and Trade Law Review* 86 https://law.uibe.edu.cn/docs/2023-04/2e83f39da73a428da86fa0e035a8025d.pdf accessed 5 January 2026.
[164] Lin Yanhua and Feng Lu, 'Securities Enforcement under the New “National Nine Articles”: New Developments in the System of Administrative Enforcement Commitments from the “Amethystum Storage Case” and “Zeda Yisheng Case”' (Fangda Partners, September 14, 2024) https://www.fangdalaw.com/content/details32_8653.html accessed 5 January 2026.
[165] Securities Law 2019, art 95: ‘Where investors file a civil compensation lawsuit for securities misrepresentation or other causes, if the subject matter of the action is of the same category and one party consists of numerous persons, representatives may be elected to conduct the litigation in accordance with the law.
For lawsuits filed in accordance with the preceding paragraph, where there may be numerous other investors with the same claims, the people's court may issue a public announcement explaining the case and the claims, and notifying investors to register with the people's court within a specified period. The judgments and rulings rendered by the people's court shall be binding on the investors who have registered.
Where an investor protection institution is entrusted by fifty or more investors, it may participate in the litigation as a representative, and register with the people's court on behalf of the rights holders confirmed by the securities registration and clearing institution in accordance with the preceding paragraph, except for those investors who explicitly declare their unwillingness to participate in the litigation.’
[166] Supreme People’s Court, Provisions on Several Issues concerning Representative Litigation in Securities Disputes (Fa Shi [2020] No 5, issued 30 July 2020, effective 31 July 2020) (‘Representative Litigation Provisions 2020’).
[167] Su Jiede (n 12).

In 2021, the China Securities Investor Services Center (hereinafter "CSISC") filed a special representative lawsuit against Kangmei Pharmaceutical on behalf of 52,037 investors.[168] This remains the civil compensation case for false statements by a listed company with the largest number of plaintiffs and the highest compensation amount in China to date.[169]

In China, securities representative litigation consists of two categories: ordinary and special. The former is a joint litigation under PRC Civil Procedure Law. It applies when the subject matter is the same or of a similar category, and the court deems a consolidated trial appropriate with the parties' consent. In such cases, the court issues a public notice for rights holders to register.[170] This type requires more than ten plaintiffs, who must select two to five representatives.[171] The latter, adopted in the Kangmei case, builds on the ordinary type but introduces the "opt-out" mechanism.[172]

Specifically, if an investor protection institution obtains special authorization from more than fifty rights holders during the public notice period, it can participate as a representative; rights holders who do not agree to join must submit an exit declaration, otherwise, they are deemed to have joined.[173] Crucially, this means the institution is deemed to have obtained special authorization from all investors who do not explicitly opt out, including the right to enter into settlement agreements. This procedural effect parallels US securities class actions.

The second major feature is administrative leadership and qualification monopoly. Unlike US class actions, although China's special representative litigation also adopts the "opt-out" principle, it possesses distinct administrative-led characteristics. The law explicitly stipulates that only officially designated investor protection institutions may act as litigation representatives.[174] Although the *2019 Securities Law* does not theoretically restrict this role to a single entity, currently, only the CSISC is qualified.[175]

This "single official representative" design stems from the public interest nature of the system. The CSISC is established and directly managed by the CSRC. It is a relatively

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[168] Chen Jie, 'A Review of China's First Special Representative Action for Securities Disputes—Preliminary Thoughts on the Litigation Rules of the Kangmei Pharmaceutical False Statement Civil Compensation Case' in Mo Jihong and Tian He (eds), *Rule of Law Blue Book: Report on China's Rule of Law Development No 20 (2022)* (Social Sciences Academic Press 2022).

[169] Wang Ying (n 13).

[170] Civil Procedure Law of the People's Republic of China (2023 Amendment) (amended by the Standing Committee of the National People's Congress on 1 September 2023, effective 1 January 2024) art 57.

[171] Representative Litigation Provisions 2020, art 5.

[172] Before the introduction of the special representative litigation system in the 2019 amendment to the Securities Law, the handling of such mass securities disputes was primarily based on the ordinary representative litigation system established by the Civil Procedure Law. On private enforcement in China's capital market, see Huang, "Private Enforcement" (n 1).

[173] Representative Litigation Provisions 2020, art 32.

[174] Robin Hui Huang, 'Class Action in China: Opportunities and Challenges' in Brian Fitzpatrick and Randall Thomas (eds), *The Cambridge International Handbook of Class Actions* (Cambridge University Press 2021) 350-365; Fa Chen, 'The Chinese-style Securities Class Action Mechanism for Investor Protection: Context, Content, Comparison and Consequence' (2022) 52 Hong Kong Law Journal 995.

[175] CSISC, '30 Questions on Special Representative Litigation' (March 2021).

independent, industry-wide third-party institution responsible to the regulator. One of its legislative goals is to avoid the moral hazard often seen in US-style class actions.[176] Unlike private counsel, the CSISC operates under public supervision with fewer conflicts of interest, thereby reducing the risk of opportunistic behavior."

However, this does not mean the CSISC lacks incentives to act. Supervised by the CSRC, the CSISC faces clear political incentives. Relevant regulations require that the cases it selects must be "typical and significant," have "severe adverse social impact," and serve as a "demonstration."[177] This selection standard is both a compromise due to the institution's limited resources and a confirmation of the special role this mechanism plays in terms of political significance and market deterrence.

The limit on representative qualification draws on the experience of the Taiwan region, where the law similarly limits the qualification of representatives in group litigation. As scholars have pointed out, without mechanisms to incentivize lawyer-led representative litigation, Taiwan's Securities and Futures Investors Protection Center has effectively formed a monopoly on litigation disputes; except for the Protection Center, it is difficult for general shareholders or investors to file representative lawsuits independently.[178] The situation in Taiwan has also led to academic concerns about whether there are sufficient incentives for special representative litigation in mainland China.[179]

Empirical research on civil compensation cases for securities misrepresentation from 2003 to 2016 shows that the actual payout rate of past cases in China was in fact higher than that of the US class action mechanism, and the payout rate in small-scale investor claims was also higher than that in the Taiwan region.[180] The main weakness of China's securities civil compensation mechanism before the law reform was not the post-judgment payout ratio, but the high costs for investors to file lawsuits and the restrictions on case filing by courts.[181]

Under the old "prerequisite procedure," investors had to wait for administrative penalties before they could sue. Furthermore, local courts, concerned about maintaining stability or local protectionism, often delayed filing or set high thresholds for group securities cases, blocking many aggrieved investors from the judicial process.[182]

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[176] For a comprehensive discussion on the agency costs and opportunistic behavior of plaintiff attorneys in US class actions, see John C. Coffee Jr., 'Class Action Accountability: Reconciling Exit, Voice, and Loyalty in Representative Litigation' (2000) 100 Columbia Law Review 370.
[177] CSISC, Rules on Special Representative Litigation (Trial Implementation) (issued 31 July 2020), art 16.
[178] Shao Qingping, 'The Public Nature of Representative Litigation by the Investor Protection Center: Examination, Reinforcement and Reflection' (2015) 44(1) National Taiwan University Law Journal 223.
[179] Li Jialu, 'Reference and Perfection of Securities Class Action in China: From the Perspective of the Investor Service Center' (2021) Z1 Science and Technology and Finance 74.
[180] Tang Xin and Chen Wang, 'Practice of Civil Justice for Misrepresentation—Review and Reflection' (2018) 1 Investors.
[181] Tang and Chen (n 180).
[182] Huang Hui, 'Civil Compensation System for Securities Misrepresentation in China: Empirical Analysis and Policy Recommendations' (2019) 3 Securities Law Review 648.

The establishment of the special representative litigation mechanism is designed to address the institutional problems mentioned above. By introducing public institutions as litigation representatives and using the opt-out rule, it significantly reduces the cost of rights defense for investors through a centralized litigation model, enabling scattered, small-claim victims to overcome rational apathy and participate in rights defense. This mechanism brings together the claims of huge numbers of investors, and the expectation of large compensation can create substantial deterrence against potential securities violations, effectively filling the gap left by the insufficient deterrent power of relying only on administrative penalties.

Regarding concerns about whether the system can be effectively implemented, the policy direction in 2025 has given a clear response, with the Supreme People's Court and the CSRC explicitly emphasizing the need to normalize securities representative litigation to help investors defend their rights.[183] Although there are positive policy signals, whether this mechanism can truly overcome the dual constraints of administrative dominance and judicial resources in practice, and achieve the expected results, still needs to be tested by future judicial cases.

A comparison with the advance compensation system reveals that civil litigation remains a significantly more protracted process. While representative litigation relies on post-event judicial determination and typically requires over a year to allocate liability, advance compensation currently operates as an empowered, voluntary settlement mechanism driven by the pragmatic commercial interests of issuers or sponsors, often concluding within two months.[184]

Despite these procedural distinctions, both the special representative litigation and the advance compensation system operate as vital investor redress mechanisms with distinct Chinese characteristics. They share a core structural reliance on administrative guidance and a practical focus on outcome efficiency. The primary objective is to protect a vast population of vulnerable retail investors by leveraging public or quasi-public institutions to overcome collective action barriers. Rather than depending exclusively on private, lawyer-led litigation, the overarching regulatory design prioritizes centralized dispute resolution to facilitate actual compensation and, although its long-term effectiveness remains to be fully tested in practice, effectively deter market misconduct.

5) High-tech Enforcement

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[183] Supreme People's Court and CSRC, 'Guiding Opinions on Strictly Enforcing Justice and Serving and Safeguarding the High-Quality Development of the Capital Market' (15 May 2025).

[184] Peng Bing, 'Reconstructing the Issuer's Liability for Civil Compensation in Misrepresentation' (2023) 43 *Journal of University of Chinese Academy of Social Sciences* 21.

In the case of Zhangzidao, this legal deterrence was further weakened by the specific evidentiary hurdles inherent in the agricultural sector. The company's core assets consisted of consumable biological assets, whose growth is highly sensitive to natural conditions, including water temperature fluctuations and natural disasters, resulting in inherently uncertain yields. Physical inventories and real-time monitoring of these assets are difficult, while transactions frequently involve large cash settlements and non-standard invoices. These obstacles enable management to conceal operating losses or perpetrate fraud by invoking "natural disasters."[185]

These structural obstacles meant that, under conventional enforcement methods, the burden of proof would almost certainly defeat the regulator. The CSRC's response in Zhangzidao was therefore not merely investigative but methodological: it deployed satellite data to reconstruct the very facts the company had refused to disclose.

Zhangzidao Corp. calculated the monthly cost of Yesso scallops based on the specific harvesting areas for that month. Since the company refused to provide relevant data and there were no daily harvesting records available for verification, the CSRC utilized the BeiDou Navigation Satellite System. They analyzed millions of positioning data points from 27 harvesting vessels. By commissioning two third-party professional institutions to use computer technology to reconstruct the vessels' actual navigation trajectories, the regulators restored the true harvesting areas over the past two years. Consequently, they determined the actual harvesting acreage and concluded that Zhangzidao Corp.'s reported costs, non-operating expenses, and profits contained false records.[186]

The application of this technology not only marked a significant innovation in the CSRC's inspection and enforcement model but also sent a powerful signal of regulatory deterrence to agricultural listed companies. Notably, in the very month that the CSRC issued the administrative penalty against Zhangzidao Corp., its subordinate Technology Supervision Bureau was officially established. This bureau established the research and implementation of Financial Technology (FinTech) and Regulatory Technology (RegTech) as its core functions.[187]

Although the Zhangzidao case represents egregious financial fraud, it harmed two distinct groups: direct A-share investors in Zhangzidao Corp., and townspeople indirectly holding shares through collective economic organizations. The former may seek compensation under existing misrepresentation rules.[188] However, the situation

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[185] Fu Yifu, 'That Zhangzidao Where "Scallops Ran Away", Why Does It Keep Having Accidents?' (*The Paper*, 16 February 2022) https://www.thepaper.cn/newsDetail_forward_16718194 accessed 5 January 2026.

[186] Chen Lingyao, 'CSRC Uses "BeiDou" Data to Investigate Zhangzidao Scallop Escape: Financial Fraud and Violation of Information Disclosure' *The Paper* (24 June 2020) https://www.thepaper.cn/newsDetail_forward_7980652 accessed 5 January 2026.

[187] Zan Xiuli, 'CSRC Science and Technology Supervision Bureau "Goes Online" to Build a New Model of Intelligent Supervision' China Securities Journal (12 June 2020).

[188] Some minority investors have also filed civil lawsuits against Zhangzidao Company claiming compensation on the grounds of 'disputes over liability for securities misrepresentation'. See Sun Xianchao, 'Affected by Investor

for the Zhangzidao townspeople is far more complex. Before the CSRC initiated its investigation in 2018, residents had already provided a real-name whistleblowing letter in 2016 signed by over 2,000 people. They alleged that the company's claim of "near-total harvest failure of Yesso scallops due to the cold water mass" was untrue and suspected fraud.[189] Following the "Cold Water Mass Incident," Zhangzidao Corp. even confiscated the relevant navigation logs.[190] It took four years before the CSRC, through satellite reconstruction of navigation results, finally confirmed the facts of financial fraud.

IV. Conclusion

Examining the cases of Kangmei Pharmaceutical, Xintai Electric, and Zhangzidao reveals that a concentrated ownership structure remains the primary institutional background for the high incidence of financial fraud in China's capital market. While the abuse of control rights by "Double Controllers" (controlling shareholders and actual controllers) offers a straightforward explanation, the reality presented by these cases is far more complex. The Zhangzidao case demonstrates that specific historical evolution and collective ownership structures can render even the legal identification of the "actual controller" inherently difficult.

Beyond the ownership complexities, these cases also reflect a capital market in transition. Kangmei, Xintai, and Zhangzidao emerged during a period of rapid institutional change: they experienced the shift from an approval-based IPO regime to a registration-based system and saw delisting move from rare to routine. Some violations concentrated the tension between a slow-moving institutional supply and a fast-expanding market. As a result, regulators and lawmakers face a dual task: resolve legacy issues appropriately while ensuring new rules keep pace with evolving market structures and risk profiles.

Crucially, these challenges largely arise from the need to align the legislative goals of the Chinese Securities Law and the Chinese Company Law. The Securities Law prioritizes investor protection and is more willing to impose direct liability on actual controllers. By contrast, although the Company Law has introduced the actual controller concepts similar to the common law "shadow director," it fundamentally upholds the company's separate legal personality and management autonomy.

A further frontier lies in the technological transformation of enforcement itself. The Zhangzidao case, in which the CSRC reconstructed scallop harvest data through BeiDou satellite positioning, foreshadows a broader regulatory shift toward Regulatory

Claims, ST Zhangzidao Expects First Half Loss of 10-20 Million Yuan' *Securities Times* (12 July 2022) https://www.stcn.com/article/detail/618503.html accessed 5 January 2026.

[189] Li Chao and Su Jianjun, '2,000 People Real-Name Report Claims Zhangzidao "Cold Water Mass Incident" is a "Huge Lie"' *Wujie News* (11 January 2016) http://finance.ce.cn/rolling/201601/11/t20160111_8200233.shtml accessed 20 January 2026.

[190] Li and Su (n 189).

Technology (RegTech) and, increasingly, the application of artificial intelligence to financial supervision. As listed companies' operations and disclosures generate ever-larger volumes of structured and unstructured data, AI-assisted anomaly detection, pattern recognition across related-party transactions, and continuous monitoring of fund flows are likely to redefine what constitutes feasible ex-ante and interim supervision, addressing precisely the kind of regulatory gap exposed by the three cases examined here.

This technological turn, however, also poses new legal questions concerning the evidentiary status of algorithmically generated findings, the protection of issuers' procedural rights, and the allocation of responsibility when AI tools produce erroneous outputs. How Chinese law accommodates these questions, while preserving due process and consistent standards of proof, will likely become a defining feature of the next phase of capital market regulation.

The question raised at the start of this chapter, whether to rely on administrative enforcement or internal governance, is therefore not a binary choice. It calls for coordinated, systemic design. Neither administrative penalties alone nor isolated civil remedies can deliver stable, predictable governance outcomes. Future efforts should focus on better aligning the Securities Law and the Company Law by refining the interaction of administrative, criminal, and civil liabilities into a multi-layered framework, while harnessing RegTech to make ex-ante supervision genuinely effective. Institutional maturity takes time, and governance risks in "controlling shareholder–actual controller" structures can be effectively mitigated only when external legal deterrence, internal checks and balances, and technologically empowered supervision operate in tandem.

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