

Special Representative Litigation in the Field of Civil Securities Disputes Brief Analysis of the System

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Abstract. As a kind of institutional innovation, the special representative litigation for securities civil disputes is of great value to protect the interests of small and medium-sized investors, enhance the efficiency of class action litigation, and promote judicial fairness and justice. This paper focuses on the institutional innovation, characteristics, superiority and shortcomings of the special representative litigation for securities civil disputes, and examines the policy suggestions for its improvement under the premise of guaranteeing fairness from three dimensions: dynamic mechanism, long-term mechanism and management mechanism.

Keywords: Special Representative Litigation System for Securities Civil Disputes; Litigation Trust; Litigation Economy.

1. Overview

According to the third paragraph of Article 95 of the Securities Law, special representative litigation means that the investor protection agency, entrusted by more than fifty investors, may participate in the litigation as a special representative and register with the people's court in accordance with the provisions of the preceding paragraph for the rights holders confirmed by the securities registration and settlement agency, except where the investor expressly does not wish to participate in such litigation. Special representatives have the following characteristics:

1.1 Public Welfare

First, the subject of the special representative litigation has a public interest. As the main body of the special representative litigation system, the main function of the investment insurance institutions is to promote and educate investors in the public interest, provide services entrusted by investors to resolve disputes, reflect the requirements of the government regulators on behalf of investors, such as small and medium-sized investors service center is a securities and financial public interest institutions approved by the Securities and Futures Commission, adhere to the public interest attributes, in addition to the necessary expenses to carry out special representative litigation, do not charge any fees.[1]

Second, the proceedings of the special representative litigation system are of public interest. In addition, investors do not need to pay the case acceptance fee in advance to the court, and even if they lose the case, they can apply to the court for remission of relevant litigation costs according to the specific circumstances of the case. These provisions reduce the cost of litigation for investors, improve the efficiency of the lawsuit to protect their rights, and help solve the problem of difficulty in prosecuting and expensive to protect their rights in the case of many and scattered investors, and help get out of the "collective action dilemma".

1.2 Innovative

The investment insurance agency is an agency specially established under the Regulations on Certain Issues Concerning Representative Proceedings in Securities Disputes issued by the Supreme People's Court for the purpose of protecting small and medium-sized investors. The investment insurance agency can be entrusted to represent issuers and intermediaries in securities disputes, negotiate matters of prior payment and damaged investors, and sign agreements. They may also hold

shares and exercise shareholder rights, such as the right to propose motions, participate in decision-making, and question the operator about the company's operations. It can also, upon application, mediate disputes between issuers and securities companies and damaged investors. Currently, only the CSRC and the China Securities Investor Protection Fund Limited Liability Company, are non-profit legal persons established for public interest purposes. They have independent legal personality and have the right to join the lawsuit in their own name. This means that the insured institutions can independently exercise their litigation rights and formally acquire the status of parties to litigation. This means that they can exercise their rights independently, and formally acquire the status of a party to the lawsuit. The insured institutions are freed from the "auxiliary role" they have been playing in securities disputes, and the line between them and securities-backed lawsuits is drawn. The attack and defense against the defendant in a group action makes it possible to simplify the form of the lawsuit to a great extent, making it possible to settle the dispute in one go.[2]

1.3 The dilemma of proof of securities misrepresentation

The core of securities misrepresentation is telling lies and releasing false information to deceive regulators, investors and the public, thereby undermining the fair and open securities market order. When an investor files a civil lawsuit for damages for securities misrepresentation, he or she will face two obstacles in proving the case:

On the one hand, it is the proof of causality, i.e., the investor needs to prove that he or she made an investment due to the misrepresentation and lost the investment due to the misrepresentation in general, loss causality and transaction causality. However, in the public securities trading market, where securities are traded in a centralized bidding manner, buyers and sellers are trading anonymously and there is no face-to-face oral fraud, and the share price is also affected by various factors, therefore, it is often difficult for investors to prove the above causality.

On the other hand, the pressure of prosecution, the number of investors affected by misrepresentation is often large, widely distributed and limited in amount, if each investor individually litigation, will not only add to the court's litigation burden, but also many investors will give up litigation because the cost of litigation exceeds the number of claims.

2. Current Situation of Foreign Research

2.1 The United States as the representative group litigation system

Rule 23 of the U.S. Federal Rules of Civil Procedure identifies three types of group actions, namely, necessary group actions, injunction-seeking and declaratory group actions, and ordinary group actions.[3]

In terms of basic procedures, the United States is the representative of the common law securities group litigation, after four developments have formed several basic rules: "plaintiffs and defendants share the costs of litigation", "attorney risk representation fees", "exit system (out-out)".

In 2010, the famous *Morrison v. National Australia Bank* case in the U.S. brought about a major change in the system. This case made the United States aware of cross-jurisdictional issues. To avoid jurisdictional conflicts and different judgments in the same case, the Securities Exchange Act provides that "the Act applies to securities fraud outside the United States only if the relevant conduct in the United States plays a substantial role in the occurrence of securities fraud outside the United States", increasing the scope of application of the restrictions, which also alleviates the risk of abuse of the United States.

In the system construction, the U.S. group litigation system on behalf of the plaintiff "declaration of withdrawal" rule instead of the original plaintiff "declaration of accession" rule, in the absence of other parties expressly objected to the premise that the parties can participate in litigation, even if no Even if there is no right subject to participate in litigation, their rights can also be effectively safeguarded by implied authorization.

2.2 Group litigation system represented by Germany

German group litigation is a system that grants certain group litigation subjects and group litigation rights, enabling them to initiate and participate in litigation on behalf of group members, independently enjoy and assume litigation rights and obligations, and independently make substantive rights dispositions. Group litigation system is a kind of one-to-one litigation system, a party to the lawsuit is a group, with the name of independent parties, unlike the representative system in China, it is not composed of victims, groups for litigation, but the actual existence of the entity organization granted special rights by the substantive law, mostly public interest organizations, which has similarities with China's insurance center, while enjoying independent civil litigation rights, can to file group lawsuits.

2.3 Regulatory Path and Features

In terms of legislative philosophy, the goal of group litigation in various countries is to achieve a balance between litigation economy and effective private enforcement of public policy, and to pursue an integrated relief mechanism for group aggression. On the one hand, it maximizes the use of judicial resources, and on the other hand, it forms a tool for public policy enforcement by consolidating numerous small lawsuits.

To address the issue of the standard of compensation awarded to investors. The German Model Law on Investor Litigation aims to facilitate the enforcement of investor claims, which are difficult to be dealt with systematically by the courts due to the large number of plaintiffs involved, as strict liability or simple negligence rules may lead to an excessive level of care in cases where the social loss is smaller than the individual investor's loss. In this regard, he suggests adapting the allocation of the burden of proof in the area of ad hoc information liability law to the existing prospectus liability rules in the area of substantive law, but using a different concept of damages.

In response to the phenomenon of abusive litigation and judicial overload. As of 2021, the securities group litigation filed in the U.S. in 2018-2021 is more than twice as many as during 1997-2017, and the judicial system faces an unprecedented threat of securities litigation, the U.S. measures to transfer offshore litigation do not fundamentally address the phenomenon of abusive litigation, and the phenomenon of multi-jurisdictional litigation leading to multiple judgments in the same case is also the root cause of the creation of different judgments in the same case. Therefore, for securities group litigation, determining the jurisdiction of the court where the group is headquartered, and the legal systems of different states vary greatly, leading to deviations in the scope of application of the same principle.

3. Superiority of The Special Representative Litigation System

3.1 Mechanism of "Implied Accession and Explicit Withdrawal"

The special representative litigation system adopts a "tacit entry and express exit" mechanism. The essence of this mechanism is that once an investor wins a lawsuit, the court's decision will have judicial res judicata effect on all investors who have implicitly joined the lawsuit, and investors who are eligible for compensation will have the opportunity to receive compensation without any effort. This system reduces the litigation costs incurred by individual investors for defending their legal rights and interests on an individual basis and lowers the threshold for investor litigation to defend their rights; on a social basis, it effectively saves judicial resources and curbs and reduces the occurrence of illegal and criminal acts in the capital market.

3.2 Provide another channel to maintain rights

This is a common advantage of representative actions, which prevent small and medium-sized investors from fighting alone and having no one to deal with them. The special representative litigation system "express withdrawal" mechanism compared with the ordinary representative

litigation system also significantly increased the number and power of small and medium-sized investors, efficient reversal of the previous securities fraud company and investor inequality, breaking the previous securities disputes are not easy to litigate the situation. Small and medium-sized investors no longer rely only on the China Securities Regulatory Commission, and litigation will become one of the best ways for them to resolve disputes in the future.

3.3 Inclusion of insured institutions

The main insurance agencies in China are the Investment Service Center and the Insurance Fund, and the insurance agencies have their own optimal solutions for ineffective litigation. Many securities disputes are won by small and medium-sized investors, but the defendant's inability to pay a high amount of compensation makes this win a nullity in a substantive sense. This dilemma has been alleviated to a certain extent by the addition of investment insurance agencies, which include the actual controller or major shareholder of the penalized company, supervisors, directors, executives, accounting firms and other intermediaries as co-defendants to assume joint and several liability, and add suitable defendants at any time according to the progress of administrative penalties, so as to punish the primary tort liability, while paying attention to the secondary liability, etc. In this way, while punishing the main infringers, we can also pay attention to the diligence obligations of the secondary parties, so as to protect investors from obtaining the maximum compensation according to the law.

3.4 Administrative pre-procedure

The latest "Supreme People's Court on several issues of litigation on behalf of securities disputes," Article 5 provides that "the plaintiff submits relevant administrative punishment decisions, criminal adjudication instruments, self-incriminating materials of the defendant, disciplinary sanctions or self-regulatory measures taken by the stock exchange and other national securities trading venues approved by the State Council, etc. to prove the fact of securities infringement prima facie evidence." Accordingly, the submission of the relevant administrative punishment decision, criminal decision, etc. has also become a pre-requisite procedure for filing representative actions. This paragraph and the previous provisions than, the pre-procedure relaxed to the defendant self-identification materials, the stock exchange and other national securities trading venues approved by the State Council to give disciplinary sanctions or self-regulatory measures taken to prove. From the perspective of the purpose of its establishment, the representative litigation system provides that there are administrative penalties, criminal penalties, etc. before it can be a reason to initiate representative litigation, this provision largely reduces the burden of case selection of the insured institutions, but also to avoid the situation of abusive litigation.

4. Disadvantages of Special Representative Litigation

4.1 The court is unclear about the scope of the criteria for selecting cases and responsible institutions

"Implied Participation" Although it expands the scope of litigation brought by investors, it can also harm the legitimate rights and interests of investors if the special representative abuses the special representation or passively performs his obligations. At present, the Securities Law and Regulations do not make specific provisions on how to regulate the conduct of special representatives of insured institutions, and the Investment Service Center Rules only briefly list the rights and obligations of the Investment Service Center and investors in Chapters 2 and 3, with no binding provisions on non-performance and abuse of the representative's rights in litigation. Under the current regulatory framework, the lack of a sound supervisory mechanism for the exercise of the litigation rights of specially authorized representatives by the insured institutions easily leads to an imbalance of power and responsibility.

4.2 Inefficiency of the special representative litigation system

Although the special representative litigation introduced the participation of insured institutions in the litigation, to some extent, increased the efficiency of the litigation. However, on the other hand, because at this stage, China's special representative litigation adopts the proxy system, under the scope beyond the provisions of the proxy, every move of the investment service center needs to obtain the consent of the small and medium-sized investors involved in the litigation, coupled with the previous ordinary representative litigation rights registration procedures, etc., to the special representative litigation dragged out the time front. The registration of special representative's rights and the examination of the plaintiff's qualification, the participation of the investment service center's representative in the litigation and the support of the insurance fund for data and evidence, other significant matters such as the investment service center's support and acknowledgement of the opponent's litigation request, waiver or change of litigation request at this stage require the unanimous consent of all plaintiffs.

4.3 Limited scope of application of the special representative litigation system

The special representative litigation system is seen as a useful attempt by China to the U.S. class action system, which is conducive to raising the cost of securities violations through high civil damages. However, special representative actions can only be applied to a very small number of cases, even in the field of securities civil disputes. And so far, there is only the first case of "Kangmei Pharmaceutical", the special representative litigation system is a long way to go to improve.

4.4 The real dilemma of insured institutions

Considering that the Chinese version of securities class action is only in its infancy and there is only one investment service center as a special representative, this may hardly meet the practical needs of the huge capital market. Therefore, according to Article 37 of the Regulation, when suing the same representative, the Investment Service Center shall participate in the litigation as a representative. However, the investment service center belongs to the special representative litigation system unique but an organizational body, and there are still many problems, mainly in the following aspects:

4.4.1 Insufficient endogenous power and lack of financial security

Due to the limitations of staffing and funding, the cases handled by public interest insurance agencies are characterized by the large number of participants, the difficulty of obtaining evidence, and the complexity of the trial process. In the usual procedures, the insurance agency in the case after the necessary fees and expenses, at the same time, the insurance agency is responsible for the appointment of public interest lawyers, investigation and evidence collection on behalf of investors to exercise the right to special representation of the effectiveness of the litigation directly affected. Due to limited funds, the human and material resources invested in the case is seriously inadequate, the lack of necessary financial protection will lead to problems such as the extremely limited number of cases handled by the insurance agency, which can not achieve the legislative purpose of the insurance agency as a special representative to protect the majority of investors.

4.4.2 Limited volume and narrow scope of cases

Up to now, there are only two insurance agencies in China, the Investment Service Center and China Securities Investor Protection Fund Co. With the increasing number of collective securities dispute cases in recent years, the annual capacity is relatively small. Facing the current situation that China's securities market is gradually reformed from "approval system" to "registration system", the number and complexity of securities disputes will only increase in the future. At present, the insurance agency shows the characteristics of small size, limited number of cases accepted and narrow scope of cases. In the case of a fixed number of insurance institutions, the number of securities disputes increases, and the insurance institutions will face a lack of skills.

4.4.3 Excessive exercise of rights

Insured institutions have a disproportionate influence in the exercise of their rights. One of the reasons is that the insured institution represents a very powerful force. Although it is only an intermediary, as soon as there is a signal that the insurance agency will file a lawsuit against a company, the securities market will immediately react to this action, and any company will have a reputational or other impact, the stockholders will lose confidence, and the company's share price will plummet, so in this respect the insurance agency will gain this authority beyond what it has. At the same time, the influence that it has beyond the scope of its authority is not necessarily positive, it can interfere with the functioning of the entire securities market and can lead to mistakes at any time. It is not just an investor, it has another identity of influence, we should be more alert to this influence.

5. Re-innovation and improvement proposals for the special representative litigation system

Despite the innovation, practicality and superiority of the special representative litigation system, there are still problems and drawbacks in judicial practice, and this paper will specifically improve the proposal from three aspects:

First, clarify the functional positioning and regulatory mechanism of the special representative system. The functional positioning of the representative litigation system for securities disputes should be to protect investors and deter violators. The special representative system is only applicable to the field of securities disputes, and should form the rules of the special representative litigation system with independence. On the one hand, the pursuit of fairness and efficiency value of investor protection should be reflected in the specific procedural and substantive rules; on the other hand, efforts should be made to solve the problem of low cost of violations such as misrepresentation, insider trading and fraud of listed companies, so as to deter violators by the system and law. At the same time, it is necessary to focus on solving the legal status of the insurance agency in the judiciary, to deal with the cultural challenge of the concept of "litigation as business", and to pay special attention to how to provide adequate incentives for public interest institutions such as insurance agencies.

Second, improve the power mechanism, efficiency mechanism and case selection criteria to promote healthy and orderly development. The rules of securities litigation need to be further refined and landed so that the system can exert its great power. China's new securities law came into effect in March 2020, and despite this amendment to the securities law to increase the punishment for securities violations and investor protection, only Article 95(3) of the Securities Law still provides for the application of the special representative litigation system, so there is a need to improve the corresponding supporting system for special representatives in the judicial field. This requires close cooperation and collaboration among the courts, investor protection agencies, securities registration and clearing agencies and other parties, especially the investor protection agencies, which are key players, should be fully prepared.

Third, the law firm as the main body of legal services, the introduction of risk agents, etc. In response to the lack of litigation capacity and incentive, we can consider encouraging the participation of high-caliber law firms, and it is difficult for individual lawyers to have the ability and responsibility to advance huge litigation costs, and it is not realistic for individual lawyers to assume the leading role as agents in securities group litigation. Law firms, especially high-caliber law firms, often have strong economic strength and professionalism, and can give full play to the great role of the market economy compared to investor protection agencies. Therefore, high-caliber law firms should be encouraged to participate in class action lawsuits and advance the costs associated with the litigation and receive an appropriate percentage of the risk representation fee upon winning the case.

Fourthly, the agency's authority to represent in litigation is specially authorized, and one of the important rights of representation is that it can represent all plaintiffs in mediation with the defendant. The adoption of special authorization for representative litigation avoids the requirement of the Civil

Procedure Law for prior consent of the representative to dispose of the substantive rights of the represented person, which often makes the litigation process cumbersome and lengthy, or even deadlocked.

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