China's Information Control Practices and the Implications for the United States

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Information Problems for U.S. Investors in P.R.C. Companies

I. Background

Companies from the People's Republic of China (P.R.C.) have been listing on U.S. stock exchanges at an increasing pace in recent years. There are currently 213 P.R.C.-based companies that are publicly traded in the U.S.[1] On the NASDAQ alone, the number of listed P.R.C. companies has tripled over the last three years, numbering 140 as of May, 2010. [2] Although these P.R.C. companies have undergone SEC review, with U.S. GAAP audited financials, as part of their U.S. registration, whether these companies have fully complied with SEC disclosure requirements and can continue to provide adequate disclosures of material information to the SEC on an ongoing basis in timely fashion remains uncertain.

II. Unique Problems of Country Risk Disclosure presented by P.R.C. Companies Listed on U.S. Stock Exchanges

One notable problem is relatively formulaic statements, accompanied by a lack of material change in the content and language of the country risk disclosure, by Chinese enterprises over the past eighteen years since China Brilliance Automotive became the first Chinese company traded on the NYSE in 1992.[3] Despite China's subsequent political and economic evolution, the country risk factor section in P.R.C. companies' prospectuses has actually shrunk over time. Minimal change in the country risks disclosed, combined with the reduction in coverage, is worrisome from the standpoint of disclosure of material information.[4]

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1 http://www.equitiesmagazine.com/china_adrs.php.

2 "Number of NASDAQ-listed Chinese Companies Tripled in Three Years," *Caijing*, May 26, 2010, available at http://www.caijing.com.cn/2010-05-26/110446857.html.

3 Erik Guyot, "Exchange Square May Face Wall St. Threat," *S. China Morning Post* (Hong Kong), Oct. 11, 1992, at 1 (reporting that Brilliance China was expected to raise U.S. $80 million in its offering on the NYSE); see also Richard Chang, "Shandong Huaneng Launches First Chinese IPO on NYSE," Reuters News, Aug. 4, 1994.

4 For instance, in the Jilin Chemical prospectus filed in 1995, the section entitled "Certain PRC Considerations" identifies eight general differences between China and the countries belonging to the Organization for Economic Co-operation and Development (OECD). Remarkably, five years after the filing of the Jilin Chemical prospectus, the prospectus filed by Netease.com, Inc., a Chinese Internet technology company, in 2000, contains a section titled "Risks Related to Doing Business in China" with almost identical language about the same eight differences between China and OECD countries. The only difference is a change in the "growth rate" factor discussed by Netease. The lack of

Another part in the China country risk factor disclosure which seems inadequate is that regarding China's legal system. Although legislation in China over the past twenty-five years has significantly improved the protection afforded to foreign investments and contractual arrangements in China, these laws, regulations and legal requirements are relatively new and their interpretation and enforcement involve many uncertainties, which could limit the legal protection available to foreign investors. Take, for instance, the P.R.C. Company Law promulgated in 1993 and revised in 2005-06. Even after almost two decades, the law and related regulations still leave a great deal of uncertainty. And yet recent P.R.C. company prospectuses make no mention of specific statutes or areas of laws that lend themselves to uncertain interpretation and enforcement. This omission leaves it to investors to figure out how laws that have been promulgated would affect the company. This is troublesome because investors are required to deduce the level of uncertainty based on their own knowledge of China. The vague and nebulous language regarding China's legal system that is found in many prospectuses exacerbates the problem of knowledge sharing.

Moreover, there is a decided trend away from more disclosure about Chinese country risk. The language has changed very little over the past decade, while the P.R.C. has changed greatly. The boilerplate language found in the country risk section raises the question of whether Chinese enterprises disclose enough information to avoid potential liability under federal securities laws for material omissions or misrepresentations in that section.[5]

III. Unique Problems of "Materiality" in the Adequacy of Disclosure Filed with the SEC by P.R.C. State-Owned Enterprises Listed on U.S. Stock Exchanges

The Securities Act of 1933 defines "material" as "[t]hose matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."[6] Subsequent case law has further adumbrated the standard: "[t]here must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."[7] For a statement to be actionable, the representation must be one of existing fact, not merely an expression of opinion,

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significant recognition of differences between OECD countries and China is especially alarming given the major shifts in the P.R.C. economy, including the reform and restructuring of state-owned enterprises.

5 In May 2004, shareholders of China Life who had purchased shares in the Chinese insurance company's December 2003 U.S. $ 3.5 billion initial public offering (IPO) filed a class action suit against the company. The suit alleged that China Life failed to disclose financial fraud that had been perpetrated by its unlisted mainland parent. It was prompted by a report issued by China's National Audit Office (NAO) in February 2004 that detailed the NAO's discovery of accounting irregularities amounting to approximately U.S. $652 million by the parent company. Subsequently, the SEC announced that it was launching an informal inquiry into China Life's IPO, the first such inquiry into a Chinese state-controlled company. Note, "Risky Business: Can Faulty Country Risk Factors in the Prospectuses of U.S. Listed Chinese Companies Raise Violations of U.S. Securities Law?" 44 *Colum. J. Transnat'l L.* 241 (2005).

6 See 17 C.F.R. § 230.405 (2005) "The term material, when used to qualify a requirement for the furnishing of information as to any subject, limits the information required to those matters to which there is a substantial likelihood that a reasonable investor would attach importance in determining whether to purchase the security registered."

7 *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

belief or expectation.

Therefore, if a Chinese SOE omits or misrepresents any existing facts, it will be liable under the Securities Act. Yet deciding whether the country risk factors in Chinese prospectuses are hard facts or soft information is much more difficult to determine. Courts are unlikely to consider statements of country risk factors as soft information or mere "puffery," since reasonable investors would probably rely on them to make decisions. For a Chinese issuer, general statements about the enormous growth potential of the Chinese market with respect to a given product or a warning about higher urban unemployment which may lead to labor unrest and disrupt future production may be considered outside the reach of the securities laws. It is worth noting that China mutual funds, issued by securities firms outside of China with portfolios of Chinese company shares, contain far more detailed and decidedly negative outlines of potential risks.[8]

However, given the lack of case law on risk factors – country risks in particular – there is still uncertainty about how a U.S. court would decide such a case against a Chinese company.

IV. Impact of Changing "State Secret" Law and Practice on P.R.C. State-Owned Company SEC Disclosures

"State secrets" have been defined by Chinese authorities in a broad sense, and agencies in charge of keeping information private are authorized to add new categories of state secrets as the need arises.[9] In

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8 *See, e.g.*, the following statement in the current prospectus for the Clough China Fund:

> Investing in China, Hong Kong and Taiwan involves risk and considerations not present when investing in more established securities markets. The Fund may be more susceptible to the economic, market, political and local risks of these regions than a fund that is more geographically diversified because:
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> - China remains a one-party, non-democratic political system with the continuing risk of nationalization, expropriation, or confiscation of property;
>
> * * *
>
> - The economic reforms being instituted could cause higher interest rates and higher unemployment, which could cause political instability. The government could also alter or discontinue economic reform programs;
> - The emergence of a domestic consumer class is still at an early stage, making China heavily dependent on exports;
>
> * * *
>
> - Military conflicts, either in response to social unrest or conflicts with other countries, are an ever present consideration;
> - Political instability may arise and hard-line Marxist-Leninists might regain the political initiative;
> - Social tensions caused by widely differing levels of economic prosperity within Chinese society might create unrest, as they did in the tragic events of 1989, culminating in the Tiananmen Square incident; and
> - The Chinese legal system is still in its infancy, making it more difficult to obtain and/or enforce judgments.

http://www.cloughchinafund.com/risks.php

9 The current state secrets framework includes the 1988 Law on the Protection of State Secrets of the People's Republic of China and the 1990 Measures for Implementing the Law on the Protection of State Secrets of the People's Republic of China. In addition, related provisions in the State Security Law (1993) and the Criminal Law (1979, amended 1997, 1999, 2001, 2002, 2005) further stipulate specific administrative and criminal sanctions for violations of state secrets or state security provisions.

1988, China enacted the Law on Guarding State Secrets which defines state secrets as "[m]atters that concern national security and interests, and the knowledge of which should be limited only to a certain scope of persons in a certain period of time by law." The law enumerates various types of secrets that fall under its coverage, including, among other things, the secret matters "in key decisions of national affairs" and "in national economic and social development." Given the fact that Chinese SOEs listed on U.S. securities exchanges are usually large companies backed by government funding, any information requested by the SEC regarding their operation potentially "concerns [China's] national interests" and "national economic and social development," thus potentially falling within the definition of state secret.

A catchall provision of the law, in the last subsection of Article 8, also allows the national State Secrets Bureau to designate things not enumerated elsewhere in the law as state secrets. Therefore, a "state secret" can be almost anything not officially made public. For example, an item that qualified in the past as a state secret was a speech to be given by then Secretary-General Jiang Zemin at the Fourteenth Chinese Communist Party Congress. The speech was leaked to a Hong Kong newspaper which published it a week before it was given. As punishment, the government sentenced the individual responsible for the leak to life imprisonment in the summer of 1993.[10] In a separate incident, a reporter who used unreleased government information about China's economic position (the extent of China's gold reserves) was arrested for stealing and leaking state secrets.[11]

In recent years, China has shown greater determination to control information relating to state secrets. The Chinese authorities just last year arrested four employees of Anglo-Australian mining giant Rio Tinto, including Australian national Stern Hu and three Chinese colleagues, on charges of stealing Chinese state secrets.[12] Although the charges were later reduced to bribery and industrial espionage, following Australia's protest, this clearly demonstrates China's willingness to use legal tools to control the flow of commercial information deemed adverse to its interests. Moreover, there were indications that this action was retaliation for a thwarted business deal whereby another Chinese SOE would have acquired a major interest in an Australian enterprise.[13]

On January 1, 2000, the State Secrets Protection Regulations for Computer Systems on the Internet (the Internet Secrecy Regulations) came into effect. Pursuant to the broad language of the State Secrets

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The Criminal Procedure Law (1997) sets forth relevant procedures for investigation, prosecution, and defense of state secrets and state security cases. This framework is further complemented by numerous laws and regulations that are not primarily a part of the state secrets framework, but include references to state secrets and to obligations not to divulge them, governing, for example, the work of lawyers, of accountants, and the use of the telecommunications network. *See* Human Rights in China, *State Secrets: China's Legal Labyrinth* (2007), at 8.

10 Allison Liu Jernow, *Don't Force Us to Lie: The Struggle of Chinese Journalists in the Reform Era*, 1994 Occasional Paper/Reprints Series in Contemp. Asian Stud. 1, 71-72. (No. 2).

11 Hong Kong *Ming Pao* journalist Xi Yang was detained by state security agents on September 27, 1993 in Beijing, and later convicted of "stealing and gathering state secrets" and sentenced to 12 years' imprisonment with two years' deprivation of political rights on March 28, 1994 by the Beijing No.1 Intermediate People's Court. Xi was eventually released on parole in January 26, 1997 due to satisfactory behavior. *See* Human Rights in China, *State Secrets: China's Legal Labyrinth* (2007), at 46.

12 David Barboza, "Rio Tinto Gave Bribes to Many, China Says," *N.Y. Times*, July 16, 2009, http://www.nytimes.com/2009/07/16/world/asia/16riotinto.html.

13 Rio Tinto jettisoned plans for a $19.5 billion tie-up with China's Chinalco in June, 2009, agreeing to set up an iron ore joint venture with rival BHP Billiton and raising cash from shareholders instead.

Law, these regulations extend the Chinese government's unlimited control of information over print media to the Internet. Each executive body producing information has the final power to decide whether a particular piece of information is "state secret," and the courts have no power to review such decisions.[14] As a result, even unpublished interest rate changes and the statistics on the number of persons being executed in China have been treated as state secrets. This is particularly worrisome given that independent media issuing financial information have also been subject to the same regulation.[15] The tight control of the media landscape and the broad reach of the State Secret Law in China add more uncertainty to the adequacy of the disclosure of information by the Chinese SOEs.

V. Adequacy of Disclosure of Communist Party Role in Appointment of Top Executives of Chinese State-Owned Companies in SEC Filings

Despite more than 30 years of transition from a planned system to a market economy, one feature that distinguishes China from other transition economies is that China still did not significantly change its political system. Correspondingly, one remaining feature of the central planning system, a politically controlled personnel system, still governs government entities at all levels, including SOEs. China's central government and Communist Party committees have the ultimate authority over the selection, appointment and dismissal of top managers of almost all large strategic SOEs under the administration of the State Asset Supervision and Administration Commission (SASAC).[16] Managers rotate through a revolving door between enterprise and government postings as they move up the political ranks, in parallel with their rise within the Communist Party.[17] Financially dependent on government grants and bank loans, these firms compete for capital in political and bureaucratic fora and have been under no real pressure to demonstrate a profit or repay.[18]

A survey conducted by the Shanghai Stock Exchange in 1999 reported that the five decisions for which local party committees exerted the most control over firms were the selection of functional department managers, business department managers, branch managers, subsidiary managers, and vice chief executive officers. Put together, the governments and party committees at different levels control the personnel decisions of the majority of Chinese SOEs.

In the banking sector, for instance, the top officials at China's financial sector regulatory agencies, the central bank, and the major state-owned banks are senior Chinese Communist Party members, whose appointments are often dictated by political considerations.[19] As a result, their financial decisions are

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[14] For the full text of the Internet Secrecy Regulations (in Chinese), *see* http://www.cnnic.net.cn/html/Dir/2003/11/27/1482.htm.

[15] Reuters, Dow Jones and Bloomberg filed a complaint with the World Trade Organization that Beijing reneged on promise to allow them access to suppliers of financial information. Instead they were required to get information from a Xinhua-news-agency distributor, which is a Xinhua subsidiary, thus giving Xinhua a virtual monopoly on financial information. In November 2008, their formal complaint based on China's WTO obligations was settled by agreeing to allow financial information providers, including Thomson Reuters, Dow Jones and Bloomberg, to distribute financial news independently of the Chinese-controlled Xinhua news agency.

[16] Stoyan Tenev et al., *Corporate Governance and Enterprise Reform in China: Building the Institutions of Modern Markets* 23 (2002).

[17] Cheng Li, "The Chinese Communist Party: Recruiting and Controlling the New Elites," 38 J. Current Chin. Affairs, No. 3, 13-33 (2009).

[18] Cull and Xu, "Who Gets Credit? The Behavior of Bureaucrats and State Banks in Allocating Credit to Chinese State-Owned Enterprises," 71 J. Development Econ. 533-559 (2003).

19 George Wehrfritz, "The Big Bank Chase," *Newsweek* (Int'l. Ed.), July 18, 2005, at 32, available at

not based purely on economic consideration. During years of lenient, government-directed lending policies, these banks provided failing SOEs easy access to credit so they could continue expanding output and employment, resulting in staggering portfolios of nonperforming loans worth hundreds of billions of dollars.[20]

Chinese SOEs have not been responsive to shareholder demand for transparency, since only a small part of their external financing comes from equity markets. The rest comes from government grants and bank loans. Corporate executives in these SOEs worry more about the concerns of political actors than what investors think.[21] Although Chinese companies listed on US stock exchanges become subject to the SEC and other U.S. rules, this may not be enough to ensure adequate disclosure and to improve governance back in China.[22]

Few analyses of corporate governance problems in China's state sector have focused on administrative interference from Communist party institutions as opposed to intervention by state actors, which have received far more attention. The Chinese Communist party continues to monitor and control economic actors at every level of the state sector. Yet the party involvement has a corrosive effect on the day-to-day governance of the vast majority of P.R.C. state enterprises. The party management structures have been criticized for aggravating inadequate monitoring of managerial performance, weakening managerial incentives, and amplifying the lack of corporate transparency. This, in turn, has created opportunities for insider control, economic corruption, and the illicit privatization of state assets. More modern corporate governance in Chinese enterprises requires the party to substantially diminish its involvement with economic entities.[23]

VI. SEC Monitoring of the Accuracy of Disclosure of Government Subsidies of Chinese State-Owned Companies

Owned by the central and local governments, Chinese SOEs receive various forms of subsidies in their operations.[24] These subsidies come mainly in forms of budgetary subsidies and bank credits. According to China's pre-accession notification to the WTO, the central and local governments together provided budgetary support to SOEs in amounts equal to about $4 billion each year in 1995-1998.[25]

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http://www.msnbc.msn.com/ id/8525725/site/newsweek.

[20] China's financial institutions held a total of 3.94 trillion renminbi (about $570 billion) of NPLs at the end of 2007. Tong Li, "China's Debt Bomb," *Forbes*, May 27, 2009.

[21] Sheridan Prasso, "A Stock Crash Is Just What China Needs," *China Business* (Dec. 15, 2007), *available at*: http://www.atimes.com/atimes/China_Business/IL15Cb02.html.

[22] In fact, the filings of Chinese oil company, Sinopec, stand out as a rare exception in detailing not only the current but also past Communist Party positions of its key personnel. For instance, it states the company's Chairman of the Board of Directors and President is also Secretary of the Communist Party of China (CPC) Leading Group of China Petrochemical Corporation. It lists his previous party and business positions going back to 1999. Also listed are the party and other positions of seven inside directors and four outside independent directors.

[23] Christopher A. McNally,"Strange Bedfellows: Communist Party Institutions and New Governance Mechanisms in Chinese State Holding Corporations," *Business and Politics*, Vol. 4, No. 1, 91-115 (2002).

[24] Julia Ya Qin, "WTO Regulation of Subsidies to State-owned Enterprises (SOEs) – A Critical Appraisal of the China Accession Protocol," 7 *J. Int'l Econ. L*. 863, 875 (2004)

[25] They were RMB32.8 billion in 1995, RMB33.7 billion in 1996, RMB36.8 billion in 1997, and RMB33.3 billion in 1998. (Note that the exchange rate between the US dollar and Chinese RMB stayed

Most of these subsidies went to textiles, coal, metal, machinery, chemical, tobacco, oil and light industries. The forms of budgetary subsidies were either grants or tax forgiveness.[26]

State banks were long required to provide credits to SOEs, irrespective of their ability to repay them. Even after such mandatory policy lending was abolished in 1998, the state banks still often rolled over unpaid credits to SOEs automatically, and gave SOEs lending priority over private enterprises. It was reported, for example, that a major state bank issued the first US dollar-denominated bond in China's domestic market in 2003, and the proceeds (about $500 million) were to be lent to SOEs to retire their existing high-cost foreign debts.[27] On the whole, state bank subsidies are less transparent than budgetary subsidies, therefore more difficult to measure and monitor.

Another type of financial assistance is given to SOEs to help them privatize or restructure, for instance repackaging SOEs for foreign direct investment or listing on stock exchanges. The SOEs chosen for this purpose have typically been restructured in advance so that they possess the most productive assets of the enterprises and are rid of redundant workers and other social welfare responsibilities for employees (such as running their own schools and hospitals). The "repackaging" of the SOEs, however, requires the state to take over the financial burdens[28] of their unproductive assets and social responsibilities, effectively subsidizing the repackaged SOEs. It is difficult, if not impossible, to estimate the magnitude of such subsidies. Few statistics are available regarding them.

Even more difficult to monitor is the various forms of preferential treatment, the "hidden subsidies," from the P.R.C. government. SOEs may be given exclusive or monopoly rights in dealing with specific products, and priority in access to natural resources and other production materials. Reuters recently reported that, along with continuing threat of Congressional action, the U.S. Commerce Department is seriously considering investigating U.S. industry charges that China's "undervalued currency" is providing an illegal trade subsidy to Chinese companies.[29] Given the complicated nature of this issue, further study with the goal of producing more China-specific regulations may be advisable.

VII. Official Agreements, Understandings and Cooperative Programs between the SEC and Its PRC Counterparts

The SEC and the China Securities Regulatory Commission (CSRC) announced in May 2006 a new relationship to increase their cooperation and collaboration through an enhanced bilateral dialogue.[30]

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constant during this period.) *See* WTO, *Protocol on the Accession of the People's Republic of China*, Annex 5A, WT/L/432, 10 November 2001.

[26] *Id*.

[27] The bond was issued by China Development Bank in September 2003 through a public tender arranged by the People's Bank of China. About 40 financial institutions participated in the tender, and the main subscribers were large state banks. The bond had a five-year term with the interest rate set at 3.65%. *See* US Commercial Service - American Embassy, Beijing, *China Commercial Brief*, Vol. 2 No. 143, 24 September 2003.

[28] Zhiwu Chen, "Stock Market in China's Modernization Process – Its past, present and future prospects," http://www.ckgsb.com/web2005/files/forum0607/rhjdzgzqs_chenzhiwu.pdf (June 1, 2006).

[29] Doug Palmer, "US weighing China currency probe - Commerce's Locke," *Reuters* (Jun. 2, 2010), *available at*: http://www.reuters.com/article/idUSN0218904120100602

30 It should be noted that this dialogue is parallel to similar arrangements between the SEC and securities regulatory authorities in other major international jurisdictions, including these:

- Committee of European Securities Regulators (CESR) Dialogue
- Japanese Financial Services Agency (JFSA) Dialogue

The new dialogue has three primary objectives:

1. to identify and discuss securities markets regulatory developments of common interest, particularly those relevant to reporting requirements for public companies listed in each another's markets;
2. to improve cooperation and the exchange of information in cross-border securities enforcement matters; and
3. to continue and expand upon the existing program of training and technical assistance provided by the SEC to the CSRC.

As set out in the terms of reference, the dialogue takes place through regular contacts among senior staff and between the Chairmen of the SEC and CSRC. This dialogue continues and enhances earlier series of exchanges between the U.S. and P.R.C. securities regulatory authorities. The SEC and the CSRC signed a *Memorandum of Understanding regarding Securities Regulatory Cooperation* as early as 1994.

VIII. Unique "Due Diligence" Problems Faced by U.S. Investment Banks Participating in Underwritings of P.R.C. Companies Seeking U.S. Listings

Given the uncertainty of the adequacy of disclosure by Chinese companies, investment banks should perhaps be more cautious when advising these clients on raising capital in the U.S., because potential liability issues are not only limited to issuers, but extend to investment banks as well. After the Enron and WorldCom bankruptcies and the dot-com meltdown, greater emphasis has been placed on underwriters to act as gatekeepers in securities markets. This emphasis is visible not only in legislation (e.g., Sarbanes-Oxley), but also in judicial decisions.

There are significant differences between doing due diligence in the U.S. or Europe and in China. First of all, the levels of transparency in financial information are generally quite low by international standards. Also, the time required to undertake meaningful diligence investigation is far greater, often three- to four-times greater than in OECD countries. Preparing the ground at the target company for due diligence may also require extensive advance work; P.R.C. companies new to overseas markets may need considerable assistance before due diligence can even commence. Financial statements according to U.S. GAAP or International Accounting Standards (IAS) may not be readily available; only accounts prepared, at best, to conform to P.R.C. GAAP may exist. These are not audited financial statements according to global standards and are not considered reliable from a US GAAP or IAS perspective. In addition, the extent of related-party transactions as well as their full disclosure may prove problematic; in the P.R.C., such transactions are often numerous, complex and inadequately disclosed. Similarly, contingent liabilities present another high risk area where the extent of such liabilities is rarely disclosed. Accounting is further hindered by the lack of computerized accounting systems; P.R.C. firms are still generally dependent on manual processes. Finally, the reliability of representations and warranties by P.R.C. firms remains largely untested. Due to deficiencies in China's judicial system, the enforceability of indemnification claims, backed by courts in Europe and the U.S., is unlikely in the P.R.C.[31]

- Korea Financial Supervisory Commission Dialogue
- Securities and Exchange Board of India (SEBI) Dialogue
- United States-European Union Financial Markets Regulatory Dialogue

[31] See Ernst & Young, "Due Diligence Factors of Success in China," http://www.eycom.ch/publications/items/china/aabs_due_diligence_factors/en.pdf.

Overall, Chinese issuers' liability issues are limited to the extent that their assets are largely, if not totally, in China. Chinese courts are not subject to any treaty or convention obligating them to recognize the judgments by courts in the U.S.[32] Therefore, chances of recovery for U.S. investors in the Chinese judicial system are low. Even if they attempt to sue such companies in China, they may find it difficult to enforce a judgment against a Chinese company in a Chinese court. A foreign judgment rendered outside of China is even more unlikely to be enforced by a competent P.R.C. court. Despite binding treaty obligations, even valid foreign arbitral awards often fail to be effectively enforced in the P.R.C. Consequently, foreign underwriters may become the potential target of frustrated litigants.

IX. Conclusion

This Commission's statutory mandate, contained in Public Law 109-108, directs it to assess, among other issues, "The extent of access to and use of United States capital markets by the People's Republic of China, including whether or not existing disclosure and transparency rules are adequate to identify People's Republic of China companies engaged in harmful activities." As the analysis above indicates, there are a number of questionable areas where issues may need to be addressed to make such an assessment.

- Risk disclosures by P.R.C. companies tend to be sketchy, formulaic and not sufficiently differentiated with regard to firms in widely disparate industries and do not demonstrate reasonable variance over time to reflect changing conditions in the P.R.C.
- "Material" information about P.R.C. companies may not be fully disclosed in keeping with SEC standards for all public companies. This may be due to inadequate levels of disclosure by P.R.C. companies generally. On the other hand, the prevalence of rote disclosure by P.R.C. registrants in U.S. securities markets may have the effect of displacing more material information.
- The expansive and fluctuating nature of what the P.R.C. defines as "state secrets" may also restrict the availability of material information and the willingness of PRC individuals and entities to disclose information that might be regarded as a state secret. This problem is further exacerbated by the potential for draconian punishment for those accused of revealing state secrets.
- In a similar vein, while state government and business positions and employment history of directors, officers and key personnel are regularly and extensively disclosed in U.S. securities filings of P.R.C. companies, there is virtually no disclosure of Communist Party involvement in the appointment process for managers, directors and officers of P.R.C. enterprises. Nor are the parallel positions of directors, officers and managers within the Communist Party described in their biographies.
- Government subsidies, both overt and disguised, are not adequately disclosed in the case of most P.R.C. companies registering securities in the U.S. As a result, the complete economic circumstances of these companies are difficult to fathom.
- Cooperation between the SEC and CSRC has held out the promise of gradual improvement in the P.R.C. securities regulatory regime resulting from the transfer of institutional learning by an

[32] The P.R.C. is a party to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

older, experienced regulator to a newly established body. Of course, much depends upon the willingness of the recipient to take advantage of such advice; however, the SEC has demonstrated a long-term commitment to this relationship which seems to have been reciprocated by counterparts in the CSRC.

- Due diligence remains both arduous and problematic with respect to P.R.C. companies. The quality of information available – as well as the amount of time required, the willingness of officials to cooperate fully and to provide complete disclosure – all present barriers to effective due diligence investigations.

Taken together, these concerns would indicate that the information provided by P.R.C. companies registering securities on U.S. exchanges remains less than optimal, in terms of full disclosure. While some initial advances have been made, largely as a result of strict statutory and regulatory requirements of the U.S. system, progress seems to have slowed or even stalled once the initial inroads were made. In certain areas, such as full disclosure of Communist Party affiliations of managers, officers and directors of P.R.C. registrants and the impact of that upon their corporations' operations, there has been little or no forward movement. Obviously, there remains considerable room for future positive development.