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□ARTICLES□

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(3) Appeals Courts (고등법원) Seoul High Court, 2003Na80798 (Jan. 25, 2005).

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Hyungbae Kim, Kyuwan Kim & Myungsook Kim, Lecture on Civil Law Theory, at 50-51 (8th ed. 2009)

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Jeongho, Kim, *A Study on the Path to Introduce the Multiple Derivative Suit in Korea*, Journal of Business Administration & Law Vol. 23, No.4, 2013. at 209-254.

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Qatari Company Liability Actions in the Shadow of Controlling Shareholders: A Comparative Analysis of Qatar and the UK

Mohsin Hamad Al-Marri [*]

ABSTRACT

The problem of this research is correlate to the doing business report of 2020 in which minority shareholders' rights in Qatar were assessed to be in a deteriorated position. The driving force of this deterioration is related to the power that controlling shareholders exert in curbing any development of an efficient minority shareholder remedy system. Controlling shareholders are prevalent in publicly held companies on the Qatar Stock Exchange. Their presence shifts the agency problem from one of agent–principal agency to one of principal–principal agency. This article highlights the inefficiency of the substantive and procedural rules for the company liability actions available to shareholders. It argues that company liability actions have been designed to foster controlling shareholders' immunity against future claims. This is dysfunctional for minority shareholders rights for the mechanics of the claim to have been designed for the sole use of controlling shareholders. This study adopts the comparison methodology between Qatar and the UK legal system. The comparison of two legal system strives to articulates the resemblance of the Qatari claim to the rule in *Foss v Harbottle*, where the proper claimants are not the shareholders but the company. As a result, the minority are at the mercy of the controlling shareholders who have the cash flow and voting rights to steer general meeting outcomes. The findings of this study revels that article 115 of Qatar Companies Law need urgent major amendments. The article suggests the repeal of article 15 of Qatari companies law and the transplantation of *prima facie threshold in the UK legal system to Qatar's civil system.*

KEYWORDS: concentrated ownership, self-dealing, corporate governance, derivative claim, agency conflict.

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ملخص

تكمن مشكلة البحث الرئيسية في إن قانون الشركات القطري حصد، في مؤشر البيئة التنافسية لريادة الأعمال، مستوى متدني في حماية حقوق أقلية المساهمين. ويعزى السبب الرئيسي لتدني حقوق الأقلية إلى السيطرة التي يمارسها المساهم المسيطر للشركات المدرجة في بورصة قطر. إذ أن الأخير ما فتئ حتى يوقف أي تطور في المجال التشريعي للحد من منح المزيد من الحقوق للأقلية التي قد تكون على حساب السيطرة المطلقة للمساهم المسيطر. ولا غرابة بأن نمط الملكية للشركات المدرجة هي التواجد المنتشر للمساهمين المسيطرين وهو ما ينشئ بذاته بعد أخر للمشكلة تعرف بمشكلة الوكالة بين الأصيل والأصيل أو الموكل والموكل. هذا البحث يتناول المشاكل التي ترتبط بالنصوص الموضوعية والإجرائية التي تقوم عليها دعوى الشركة. ويناقش البحث فكرة أن دعوى الشركة في القانون القطري إنما وضعت حتى لا تستعمل من قبل الأقلية، بل إنما هي أداة للاستعمال من قبل المساهمين المسيطرين فقط وهو ما ينذر بذاته أن الأقلية إنما جردوا من الوسائل القانونية للجوء إلى قاضي الموضوع ذودا وحماية لحقوقهم. وفي إطار المنهجية المقارنة بين النظام القانون القطري والبريطاني، نجد بأن الأخير قد عانى من مشكلة دعوى الشركة لديه عبر نظام السوابق القضائية التي حددت إطار دعوى الشركة في القاعدة القانونية التي أرسيت في قضية *Foss v Harbottle* في إن صاحب الصفة في رفع الدعوى ممثلة في الجمعية العمومية للمساهمين وليس المساهم بشخصه. والأثر المترتب لذلك هوعدم جدوى دعوى الشركة واختلال المراكز القانونية لأقلية المساهمين تحت رحمة السلطة المطلقة للمساهم المسيطر بسبب فارق حجم التصويت بينهم. وتكمن نتيجة البحث وتوصياته في إلغاء المادة 115 من قانون الشركات التجارية القطري، وتبني مبدأ الوهلة الأولى أو ما يسمى *prima facie في نظام قانون الشركات.*

KEYWORDS: concentrated ownership, self-dealing, corporate governance, derivative claim, agency conflict.

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I. Introduction

The Qatar Stock Exchange (QSE) suffers from a unique problem: majority shareholders holds greater number of shares. The concept of ownership itself includes a complex of benefits but also problems. While it is true that the controlling shareholders prevent a misalignment of interest between management and the company by curbing any opportunistic practices of managers against the company, it also creates problems when it comes to the use of dominant power of controlling shareholders . Therefore it is natural that minority shareholders in a concentrated ownership structure only possess poor opportunity to access information and to company's activities. As a result, the position of minority rights needs to be guaranteed against the influx of foreign direct investment into the stock market.

Therefore, it is imperative to assess minority shareholder safeguards within the legal framework of shareholders' safeguards at an international level. It will help reassure outside investors by showing how the legal framework and protective instruments are well prepared for them. The main concern of minority shareholders is protection against expropriation, legal strategies and

the solidity of the disclosure and transparency system in the stock market via company liability action in the Qatari model[1] or derivative claim in the UK model[2]. In the Doing Business reports between 2018 and 2020,[3] Qatar scored poorly in the evaluation of minority shareholders' rights on the QSE. This Qatar's position reveals the chronic problem suffered by minority shareholders in the presence of controlling shareholders.

Given that minority shareholders lack internal legal strategies, they may be forced to use their right only by litigations in case of curbing the opportunism of controlling shareholders. The quality and functionality of last-resort legal strategies before the court is a key element in the alleviation of agency cost among corporate parties and the dynamism of the company. Instead of shareholders voting with their feet, they can act on behalf of and in the name of the company, to protect its wealth against expropriation.

II. The Research Problem

Qatar Corporate Law No 11 of 2015 (QCL) claims that shareholders' remedies, particularly company liability actions under article 115 of the QCL, have been designed to be dysfunctional and impractical to the interest of minority shareholders. In fact, the mechanics of the statutory action have been constructed to be utilized solely by controlling shareholders. Under the QCL framework, minority shareholders' lawsuits and judicial proceedings justly related to the company's cause of action are markedly constricted. Qatar suffers from a structural problem concerning the functionality of substantive and procedural mechanisms for company liability actions. The structure prevents minority shareholders from pursuing the rights of the company against wrongdoers and imposes immense thresholds for claims to be filed. Minority shareholders are unable to file company liability claims against wrongful acts, in the name and benefit of the company. The result is the narrowly limited roles that companies enjoy protecting their assets against wrongdoers. The Qatari model related to company claims is considered to be severely outdated and rudimentary as it restricts claims counter to the discretion of general meetings (GMs) of shareholders. As a result, the company – as a separate legal entity – and minority shareholders conduct a limited role in the system of litigation against wrongdoers.

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[1] See section 4. of the research.

[2] See section 4.1 of this research.

[3] World Bank, <https://www.doingbusiness.org/content/dam/doingBusiness/media/Annual-Reports/English/DB2018-Full-Report.pdf> accessed 18 February 2023 at 184. For more, see Word Bank standards and score of protecting minority protections 2018–2022.

A. Methodology

Against this backdrop, this research conducts a comparative analysis between Qatar and the UK, in terms of company liability actions and derivative claims. It is worth comparing as UK has developed a well-organized system due to the application of the Company Act 2006 in light of *Foss v Harbottle* and the later application of the statute. Particularly, as the problem of shareholders' remedies in Qatar, particularly the structural problem of substantive and procedural company liability actions, is similar to the *Foss v Harbottle* issue.

Before delving deeper to the substantive and procedural structural problems of company liability action, it is imperative to discuss the layout of ownership structure in Qatar in light of the concept of shareholder democracy. This gives a vivid idea of how ownership and the presence of controlling shareholders prevent minority shareholders from pursuing the right of litigation on behalf of the company.

III. The Role of Corporate Law in Minority Shareholder Protection

Corporate law provides legal strategies demonstrating how to deal with duties and obligations.[4] It is a mechanism to reduce agency cost and alleviate the agency conflict between two layers: capital providers – such as minority shareholders – and agents – management or minority shareholders and controlling shareholders.[5] Corporate law is meant to deliver procedural and substantive legal strategies for shareholders to curb existent and potential expropriations or acts of majority abuse of a company's assets.[6] The optimal objective of legal strategies is to protect the company's capital against the misalignment of corporate participants within the company.[7]

Conferring rights on minority equity holders to file legal proceedings raises a number of problems. Undisputedly, an investor holding a share of the company pledges to abide by the majority decision-making outcomes of the company's democratic system as a result of a number of entrenched principles.[8]

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[4] John Armour and others, 'Agency Problems and Legal Strategies' in Kraakman and others (eds), The Anatomy of Corporate Law: A Comparative and Functional Approach, 3rd edition, Oxford University Press, United States, 2017, pp. 31.

[5] Francesco Denozza and Alessandra Stabilini, Principals vs Principals: The Twilight of the Agency Theory, Italian Law Journal, Volume 3, Issue 2, April 2017, pp. 512.

[6] Ibid.

[7] Gonzalo Villalta Puig and Bader Al-Haddab, The Protection of Minority Shareholders in the Gulf Cooperation, Journal of Corporate Law Studies, Volume 13, Issue 1, April 2013, pp. 124.

[8] Maleka Femida Cassim, The Statutory Derivative Action under the Companies Act of 2008: The Role of Good Faith, South African Law Journal, Volume 130, Issue 3, January 2013, pp.

First, a person who injects more capital has more shares and votes. Thus, the capital of majority shareholders is severely exposed to the fluctuation of market prices and business risks. Second, underpinning the common corporate law system is the majority rule principles, where the majority of shareholders have the right to steer the company's business strategies. However, majority rule is not absolute, therefore should be balanced in the interests of the company.

As a result, one of the legal strategies afforded by corporate law is a company liability action.[9] This is an optimal legal instrument to curb the expropriation of shareholders' wealth. It is a statutory action available to shareholders of publicly held companies to protect the company's wealth and curb the misalignment of interest between corporate participants. The action – as a last-ditch effort if internal corporate mechanisms fail – is filed in the name and benefit of the company against wrongdoers and third parties in the event of acts of fraud, misuse of authority, breaches of law or the company's articles of association, and gross mistakes in performing their duties. The action is of paramount importance to the functions of corporate governance (CG) because it provides a platform for wronged shareholders to enforce directors' duties towards the company's interest, discourage wrongs by directors or controlling shareholders, recompense the company – as a separate legal entity – for any damages it has suffered, and finally set the direction of business conduct under the supervision of the court.[10]

A. Majority Rule and Corporate Democracy

Shareholder democracy is defined as 'ensuring that interested shareholders [are] sufficiently informed (through improved publicity) and able to vote their shares (through proxy reforms)'.[11] The main driver of corporate law is to fuel and activate corporate democracy by encouraging shareholders to actively engage in the procedure of monitoring company's activities.[12] Despite corporate democracy advocating for equivalence between the participation of shareholders at the GM and the decision-making process, the abuse of the majority rule is what concerns corporate law and CG literature in accordance

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[9] A company liability action is a statutory action filed by the name of and in the benefit of the company with the approval of general meeting of shareholders.

[10] Qamarul Jailani, Derivative Claims under the Companies Act 2006: In Need of Reform?, UCL Journal of Law and Jurisprudence, Volume 7, Issue 2, 2018, pp. 73.

[11] Colleen Dunlavy, Social Conceptions of the Corporation: Insights from the History of Shareholder Voting Rights, Washington and Lee Law Review, Volume 63, Issue 4, Fall 2006, pp, 1365.

[12] Dov Solomon, The Voice: The Minority Shareholders' Perspective, Nevada Law Journal, Volume 17, Issue 3, Summer 2017, pp. 744.

with the application of the 'one share, one vote' rule.[13] Corporate law is concerned with the relationship between a company's internal management and its directors and shareholders.[14] Its main objective is to reduce agency cost by dividing decision-making powers between directors and the GM in the 'best interests' of all shareholders.[15] The pragmatic application of corporate democracy is to shift the power of directors to shareholders in engaging dynamically in the decision-making process at a GM via voting and monitoring the activities of key players in the company.[16]

It is clear that corporate democracy underpins majority rule as the legitimate basis of decision-making channels, steers the company's direction and determines its interest.[17] The manifest example of underpinning is confined to the functions of the GM: the engagement of shareholders with management through inquiries about the company's activities, information flow by the management to shareholders about the company's status, and, importantly, the decision-making process that is conducted by a majority vote among shareholders.[18] The majority rule is broadly observed as a legal basis for the landscape of the company's decision-making process, and its decisions are binding on all shareholders.[19]

The main obstacle in Qatar, in the absence of substantive and procedural rules, is when majority rule is used as a means of oppressing minority shareholders for the benefit of a certain class of shareholders. The apprehension is about the majority's oppression when they appropriate for personal desires the private benefits of the company or expropriate the company's resources.[20] The ability of the majority to appoint directors and pass resolutions smoothly at a GM, along with increasing shareholder apathy, may be appropriate for family members in management and their unreasonable rewards that affect the company's long-term strategic plan to meet block-holders' personal and

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[13] Ann Buchholtz and Jill Brown, 'Shareholder Democracy as a Misbegotten Metaphor' in Maria Goranova and Lori Ryan (eds), Shareholder Empowerment: A New Era in Corporate Governance, 1st edition, Palgrave Macmillan, United States, 2015, pp. 88.

[14] Grant Hayden and Matthew Bodie, Shareholder Democracy and the Curious Turn toward Board Primacy, William and Mary Law Review, Volume 51, Issue 6, May 2010, pp. 2074.

[15] Ibid.

[16] Ann Buchholtz and Jill Brown, 'Shareholder Democracy as a Misbegotten Metaphor' in Maria Goranova and Lori Ryan (eds), Shareholder Empowerment: A New Era in Corporate Governance, 1st edition, Palgrave Macmillan, United States, 2015, 83.

[17] Iain Macneil, An Introduction to the Law on Financial Investment, 2nd edition, Hart Publishing, United States, 2005, pp. 262.

[18] Anne Lafarre, The AGM in Europe: Theory and Practice of Shareholder Behavior , 1st edition, Emerald Group Publishing, UK, 2017, pp. 7.

[19] Roger Barker and Iris Chiu, Protecting Minority Shareholders in Block-Holder Controlled Companies: Evaluating the UK's Enhanced Listing Regime in Comparison with Investor Protection Regimes in New York and Hong Kong, Capital Markets Law Journal, Volume 10, Issue 1, January 2015, pp. 100.

[20] Ibid.

idiosyncratic objectives. For example, the presence of one single shareholder holding a majority of shares 'underprovide[s] quality or otherwise shortchange[s] the firm's stakeholders because of their single-minded focus on profits'.[21] Even more seriously, they enter into related party transactions (RPTs), or tunneling practices, such as choosing certain suppliers and appointing incumbent directors.[22]

The preamble of the Qatar Financial Market Authority (QFMA) CG Code of 2016 demonstrates explicitly that, owing to corporate democracy and implicitly to ownership concentration in the hands of families or the government, the application of majority rule may cause prejudicial conduct against minority shareholders by controlling shareholders who may steer the company based on their sole perspective.[23] Therefore, the QFMA CG Code and the QCL strive to suppress the control of the board by one single shareholder through three legal mechanisms.[24] The first is the introduction of cumulative voting for minority shareholders so that they can cast, partly or wholly, votes for an individual or a group of candidates. The second is the introduction of independent directors to balance powers inside board deliberations.[25] The third is juridical protection through revocation actions.

Significantly, corporate law and CG are supposedly designed to prevent majority shareholders from intervening in the board's main functions to the company.[26] The board is legally and morally liable for the company's success; they are not obligated to follow orders from controlling shareholders about the company's direction.[27] Directors are not servants of majority orders but pursue the corporation's benefit and represent all stockholders, not a certain class who voted for them.[28] Directors acting *bona fide* in the interest of the company are not obligated to follow the majority shareholders' desires and instructions even though they hold the majority of shares and power.[29]

It is believed that a primary principle in the general provisions of the law is to impose constraints on any person who enjoys power and control over the

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[21] Andrei Shleifer and Robert Vishny, A Survey of Corporate Governance, The Journal of Finance Volume 52, Issue 2, June 1997, pp, 767.

[22] Roger Barker, Corporate Governance, Competition, and Political Parties: Explaining Corporate Governance Change in Europe, 1st edition, Oxford University Press, United States, 2010, pp. 38–39.

[23] Preamble to the QFMA Corporate Governance Code of 2016.

[24] Ibid art 6.

[25] Ibid.

[26] Stephen Bottomley, The Constitutional Corporation Rethinking Corporate Governance, 1st edition, Ashgate Publishing, England, 2007, pp. 21.

[27] Ibid.

[28] Anupam Chander, Minorities, Shareholder and Otherwise, Yale Law Journal, Volume 113, Issue 1, October 2003, pp. 127.

[29] Iris Chiu, The Foundations and Anatomy of Shareholder Activism, 1st edition, Bloomsbury Publishing, United States, 2010, pp. 112.

property of others.[30] The proportionate voting power, in accordance with majority rule, between controlling shareholders and the minority is critical because it controls board nominations, elections, the results of resolutions, and the appointment of management.[31] Through the constraints on majority power, corporate law strives to create a legal framework of safeguards and indemnification to protect shareholder interests from oppressive practices and divergence of interests.[32] Based on democratic principles, the majority may impact shareholder legal rights and bind the minority with desired decisions.[33] The result is an imposition of fiduciary duties on the majority or controlling shareholders and, consequently, the law will prevent the abuse of authority by fiduciaries.[34]

B. Ownership Structure and Non-separation of Ownership and Control

The system of CG in Qatar enjoys a unique ownership structure. Ownership is highly concentrated in the government and political families. As a result, the concept of separation of ownership and control, as in the US and UK, does not yet exist. In fact, it is rare for the QSE to find a company with a fragmented ownership structure, as families and controlling shareholders are reluctant to relinquish either control or ownership. As Baydoun and others argue, political families are fierce competitors against minority shareholders when it comes to new capital increases or initial public offerings (IPOs).[35]

The problem is revealed with the existence of the system of controlling shareholders in publicly held companies on the QSE. Controlling shareholders such as families with political relations and the government of Qatar play a key role in the leadership and ownership of a majority of companies.[36] According to Amico, 65% of companies listed on the QSE are owned directly or indirectly

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[30] Kenneth Davis, Judicial Review of Fiduciary Decision Making—Some Theoretical Perspectives, Northwestern University Law Review, Volume 80, Issue 1,1985-1986, pp. 1–2.

[31] Lisa Fairfax, The Future of Shareholder Democracy, Indiana Law Journal, Volume. 84, Issue 4, Fall 2009, pp. 1288.

[32] Ibid.

[33] Zipora Cohen, Fiduciary Duties of Controlling Shareholders: A Comparative View, University of Pennsylvania Journal of International Business Law, Volume. 12, Issue 3, Fall 1991, pp. 380.

[34] Ibid. It is one of the criticisms AL-Shazly directed at policymakers that, due to the ownership structure in Qatar, controlling shareholders have no duty to the minority shareholders. See Yassin el Shazly, Public Shareholding Companies in the New Qatari Corporate Law: Flexibility and Efficiency, Asian Business Lawyer, Volume 19, Issue 2, 2017, pp. 109.

[35] Nabil Baydoun and others, Corporate Governance in Five Arabian Gulf Countries, Managerial Auditing Journal Volume 28, Issue 1, January 2013, pp. 10.

[36] Ibid.

by the government of Qatar.[37] In addition, the ownership structure of families is widespread and rooted in the corporate ownership and leadership of companies. The deeply rooted concentration of ownership and control and active role of controlling shareholders are associated with 'low transparency levels, ineffective powers of oversight and scrutiny, a culture of excessive secrecy and over-reliance on personal relationships'.[38]

As a result, the ownership structure of the QSE creates an opaque agency conflict in the corporate landscape. Minority shareholders deal with different misalignments of interest due to the strong presence of controlling shareholders at GMs, which oversee the corporate stewardship and decision-making process. The system of CG on the QSE suffers from principal–principal agency conflict. Minority shareholders in Qatar are not concerned with a misalignment of their interests with management because the system of controlling shareholders places rigorous supervision on their managerial practices. However, the problem is that the controlling shareholders enjoy ample power to run the corporations as they please, with no effective legal mechanisms to curb any misalignment.[39] The ultimate outcome for minority shareholders in the absence of voice and legal liability is to use the existing mechanism of dumping their shares on the market. In other words, minority shareholders are forced to vote with their feet to express their dissatisfaction with the controlling shareholders' practices and power.

IV. The Mechanics of the Company Liability Action Problem

In light of the foregoing problems of ownership structure on the QSE and the system of controlling shareholders' key roles, it is vital to investigate the key issue of company liability actions. The understanding of a company's separate legal entity is paramount to understanding the problem of company liability actions. According to the doctrine of a separate legal entity, if a wrong is suffered by the company, the company itself, not its shareholders, is a proper plaintiff eligible to file a legal action against the wrongdoers.[40] That being said, it is at the discretion of the board of directors to pursue the claim against wrongdoers under their decision-making authority in the articles of association (AOAs) and QCL.[41] However, the problem that Qatar suffers from is usually

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[37] Alissa Amico, Arab States as Shareholders: Origins and Consequences, Combining Economic and Political Development, Volume 17, Issue 7, January 2017, pp. 33

[38] Nabil Baydoun and others, Corporate Governance in Five Arabian Gulf Countries, Managerial Auditing Journal Volume 28, Issue 1, January 2013, pp. 10.

[39] Rafael La Porta and others, Corporate Ownership around the World, The Journal of Finance,Volume 54, Issue 2, December 2002, pp. 473.

[40] Salomon v A Salomon & Co [1897] AC 22 (HL) 51.

[41] Arts 114 and 115. There are different scenarios for how the claim can be filed. In general, a

that the wrongdoers are in fact the directors and controlling shareholders themselves, and they will not pursue the company's claim and will prevent any attempt to file such a claim.[42]

According to article 115 of the QCL

> The company may file a liability claim against the members of the board of directors due to mistakes resulting in damages to all shareholders within five (5) years from the date of such mistake. The ordinary general assembly shall resolve the filing of such claim and shall appoint a representative to commence a claim. If the company is under liquidation, the liquidator shall undertake filing the claim upon a resolution passed by the general assembly.

Article 115 clearly explains the conditions in which the claim can be filed. First, the wrongdoing must be established against the company as a separate legal entity. Second, a general assembly of shareholders must be convened to discuss and deliberate the seriousness of the wrongdoing. Third, the claim cannot be filed unless the shareholders pass a resolution approved by a majority of votes. Fourth, if the GM approves the shareholders' resolution, the GM will appoint a legal representative, with the authority of the GM, to file the claim on behalf of and in the name of the company.

A. Pre-statutory Company Liability Action Requirements

Unlike UK derivative claims where a claimant has the ability to file the claim without the need for GM approval,[43] the Qatari model enjoys of plethora of thresholds. First, prior to seeking GM approval to file the action, minority shareholders who own no less than 10% of the company's shares must file a request to the company to convene a GM.[44] The threshold test is intended to resolve the company's issue and the wrongdoing internally before judicial intervention is pursued into the company's internal business. Achieving this step requires minority shareholders to be sufficiently active and dynamic to start campaigning to solicit votes to reach the required percentage to call for a GM. Alternatively, shareholders may avoid the 10% threshold to add this matter to the agenda for the annual general meeting of shareholders. The latest set of amendments requires that shareholders hold 5% of shares to add the topic of

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company liability action is designed to be filed against all wrongdoers. However, once a company has suffered from a wrong by a single director, the general meeting must convene to remove director, and at the same time appoint a legal representative (the chair of the board) to file the claim in the name and benefit of the company.

42 Qamarul Jailani, Derivative Claims under the Companies Act 2006: In Need of Reform?, UCL Journal of Law and Jurisprudence, Volume 7, Issue 2, 2018, pp 72–73.

43 Section 261 of the UK Corporate Companies Act 2006.

44 Article 124 of Qatar Corporate Law No 11 of 2015.

filing the action to the agenda.[45]

Second, once the GM is convened, shareholders must discuss the possibility of filing the claim against wrongdoers – directors or controlling shareholders – who misuse the company's wealth. According to the doctrine of corporate democracy, the decision-making process of the company's interest at the GM must be conducted via voting.[46] The general rule is that voting at the GM shall be in accordance with the company's AOAs. However, a secret ballot is mandatory if the resolution relates to the election of members of the board of directors, removing them, or filing a liability claim against them.[47]

However, the problem with the shareholding structure in Qatar, as discussed earlier, is related to the ownership structure of publicly held companies. The majority landscape of ownership is identified as highly concentrated ownership, where a single shareholder – a family or the government as a shareholder – owns more than 50% of the company's shares either directly or indirectly. Arguably, it would be far-fetched for controlling shareholders – who own the majority of shares and monitor management appointed at their pleasure and create their own loyal board members – to vote against their own interest.[48] The claim, indeed, if filed, would target the interests of the controlling shareholders and, as a result, would be unlikely to be filed owing to the risk to the majority control of the company. Therefore, the system of controlling shareholders must be explained in order to understand the dysfunction of the current framework of company liability claims.

B. The Immunity of Controlling Shareholders and a Shadow Director

The system of controlling shareholders in Qatar creates a two-layer agency conflict in this situation. First, there is a misalignment between the interests of minority shareholders and those of the controlling shareholders.[49] The latter, owing to their privileged position in the company, are well-informed about the company's information, projects, and activities. Therefore, controlling shareholders may engage in an RPT to benefit from the transaction from both sides.[50] Second, the controlling shareholder may lose absolute control of the

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[45] Ibid Art 129.

[46] Harvey Frank, The Future of Corporate Democracy' Baylor Law Review, Volume 28, Issue 1, Winter 1976, pp, 41–42.

[47] Article 133 of Qatar Corporate Law No 11 of 2015.

[48] Lucian Bebchuk and Assaf Hamdani, Independent Directors and Controlling Shareholders, University of Pennsylvania Law Review, Volume 165, Issue 6, May 2017, pp. 1287.

[49] John Armour and others, 'Agency Problems and Legal Strategies' in Kraakman and others (eds), The Anatomy of Corporate Law: A Comparative and Functional Approach, 3rd edition, Oxford University Press, United States, 2017, pp. 29–31.

[50] Ronald Gilson and Jeffrey Gordon, Controlling Controlling Shareholders, University of Pennsylvania Law Review, Volume 152, Issue 2, December 2003, pp. 785-844.

company via a pyramidal ownership structure where they create a series of companies and subsidizers to affect the direction of the board's elections and GM resolutions.[51]

Based on the above discussion, article 115 of the QCL is narrowly limited in facing any act of expropriation by the controlling shareholders. Article 115 is strictly limited to being filed against boards of directors and excludes controlling shareholders, as an appointor, to the controlling shareholders' appointees. In fact, controlling shareholders will nominate their closed inner circles of loyal employees to ensure that their orders will be followed and respected.[52] The fact that the QCL does not recognize the concept of a shadow director constricts the probability of holding a controlling shareholder liable for their wrongdoing.

In addition, the system of company liability action is incomplete for three reasons. First, it only recognizes as de jure directors those who have been legally elected in accordance with the company's AOAs and the QCL. However, the QCL does not recognize the effect and concept of a shadow director. A shadow director is a person who is not appointed or elected as a director but 'whose directions or instructions the directors of a company are accustomed to act'.[53] In other words, a shadow director is a person who instructs and stewards the company's decision-making behind the scenes.[54]

Given the fact that the corporate structure of a company's ownership is highly concentrated, it is highly common to find controlling shareholders who, alone, own most of the shares to appoint directors from their inner circle of trust. Appointed directors are supposed to be independent but they are influenced by the appointor's instructions, directions, and decisions. According to an IMF report, 'the appointment of independent non-executive directors with no association with controlling shareholders is not a common practice in [Qatari companies]'.[55]

Second, the discretion to take a company liability action is confined to the power of the GM. In view of the fact that 65% of publicly held companies are controlled by the government of Qatar as a shareholder and the rest are left to family ownership, minority shareholders are unable to exercise their proprietary

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[51] Simon Johnson and others, Tunneling, The American Economic Review, Volume 90, Issue 2, May 2000, pp. 22-27.

[52] Nabil Baydoun and others, Corporate Governance in Five Arabian Gulf Countries, Managerial Auditing Journal Volume 28, Issue 1, January 2013, pp. 11.

[53] The UK Companies Act 2006, s 251.

[54] Natania Locke, Shadow Directors: Lessons from Abroad, South African Mercantile Law Journal, Volume 14, Issue 3, 2002, pp. 421.

[55] André Oliveira Santos, 'Integrated Ownership and Control in the GCC Corporate Sector' (2015) IMF Working Papers WP/15/184 <https://www.elibrary.imf.org/view/journals/001/2015/184/001.2015.issue-184-en.xml> accessed 9 March 2022.

rights from their shares owing to absolute control by the dominant shareholders. Therefore, the role of the company as a separate legal entity is restricted to the presence of minority shareholders. Sharar argues that shareholders' remedies in Qatar, particularly company liability actions, lack procedural and substantive rights for minority shareholders against expropriation by controlling shareholders.[56]

Third, the level of shareholder activism in Qatar is problematic.[57] GMs in listed companies have witnessed the remarkable phenomenon of minority shareholders refusing to attend. The apparent reason is related to the fact that minority shareholders' attendance at GMs makes no difference because of the disparity of cash flow and share possession between the controlling and minority shareholders. The more subtle reason relates to the low level of transparency and disclosure practices endemic in listed companies' CG practices. As a result, controlling shareholders are well-informed about the company's business and business complexities, whereas minority shareholders have to wait a year to be poorly informed about an RPT disclosure.

V. A Historical Appraisal of the UK Common Law Derivative Action

Prior to the enforcement of the UK Companies Act 2006, derivative actions were initiated under the common law. According to the rule in *Foss v Harbottle*[58] (*Foss*), shareholders are not the proper claimant for filing a claim on behalf of the company. It is at the discretion of the GM of shareholders to approve such a claim against wrongdoers. In other words, once a wrongdoing is committed against the company, the proper claimant is the company itslef as a separate legal entity.[59] The rule creates two doctrines. The first is the proper claimant rule, which emphasizes that the company entity is distinguishable from its shareholders as the company has the legal competence to owe legal obligations and pursue its legal rights.[60] As Lord Halsbury LC indicated, 'once the company is legally incorporated, it must be treated like any other

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[56] Zain Sharar, Corporate Governance in Qatar: A Comparative Analysis (12 January 2011). Bond University – Corporate Governance eJournal 2011, Available at SSRN: https://ssrn.com/abstract=2996910.

[57] Shareholder activism is a term refers to an activist investor attempt to make some c hanges to the company's decision, direction and idiosyncratic Vision via voting, camp aigning or litigating against directors.

[58] Foss v Harbottle 2 Hare 461 (1843).

[59] Julia Tang, 'Shareholder Remedies: Demise of the Derivative Claim?' UCL Journal of Law and Jurisprudence, Volume 1, Issue 2, July 2012, at 179–81.

[60] Salomon v. Salomon & Co [1897] AC 22.

independent person with its rights and liabilities appropriate to itself'.[61] As a result, when a wrong occurs against the company, it is up to the company itself to file claims to seek remedies. The second doctrine is the majority rule principle, which indicates that, if a wrong is approved and ratified by a GM of shareholders, the court has no legal jurisdiction to intervene in the matter of shareholder democracy.[62]

It is true that the application of *Foss* hinders and blocks malicious proceedings from being brought against the company; however, it also prevents solid claims from being filed against wrongdoers. The outcome is that shareholders do not enjoy the procedural and substantive legal rights to file claims on behalf of the company. The Law Commission concluded that the *Foss* rule is 'inflexible and outmoded'.[63] However, the enlightenment of *Edwards v Halliwell*[64] extends the understanding of *Foss* rule exceptions. First, minority shareholders have *locus standi* to file a claim against wrongdoers where exceptions are applicable. According to Jenkins LJ, (1) the act complained of must have been unlawful or *ultra vires*; (2) the underlying matter must have required the sanction of a special majority or there was no compliance with a special procedure; (3) a member's personal rights must have been infringed; and (4) a fraud must have been perpetrated on the minority and the wrongdoers must be in control.[65]

The most instrumental method available for minority shareholders is the exception for fraud against them.[66] This exception is illustrated by a controlling shareholder acting as a director and majority shareholder at a GM who has embezzled the company's assets and prevented any proceedings from being initiated against them. In this case, shareholders were permitted to seek corporate relief by filing a common law derivative action on behalf of and for the benefit of the company against the majority's wish.[67] The claim must meet two conditions. First, the minority shareholder must prove to the court that the majority that is in control of the company committed fraudulent acts related to the company's assets.[68] Second, the majority shareholder must have benefited personally from the fraudulent acts at the expense of the company.[69]

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[61] *Id.*

[62] Burland v. Earle [1902] AC 83.

[63] Law Commission, Shareholder Remedies (Law Com CP No 142, 1996) (LC Consultation Paper) para 14.1.

[64] Edwards v. Halliwell [1950] 2 All ER 1064

[65] Edwards v. Halliwell [1950] 2 All ER 1064.

[66] Jingchen Zhao, Promoting a More Efficient Corporate Governance Model in Emerging Markets through Corporate Law, Washington University Global Studies Law Review, Volume 15, Issue 3, January 2016, at 484.

[67] *Id.*

[68] Agustin Spotorno, Why Is the Rule in Foss v. Harbottle Such an Important One, Business Law Review, Volume 39, Issue 6, December 2018, at 191.

[69] *Id.*

Overall, sanctions in relation to acts of fraud have not been permitted because fraudulent wrongdoers who are in control of the company will not seek corporate relief against themselves.[70] By dint of the wrongdoers' control of the company, claims seeking to benefit the company will be struck down by the wrongdoers.[71] Therefore, exceptions have evolved to allow members of a company to seek corporate relief, especially in the ambit of acts of fraud.

The deeply rooted issues ingrained with the *Foss* rule were highlighted by a Law Commission report. The Law Commission emphasized the need for 'a new derivative procedure with more modern, flexible and accessible criteria for determining whether a shareholder can pursue an action'.[72] The driving force for the change was related to the unhealthy development of shareholders' remedies in the UK. The rule in *Foss* and its exceptions were seen as 'rigid, old fashioned and unclear'.[73] In such a situation, modernization of the derivative proceedings was necessary for the development of the financial markets; however, the report did not encourage a deluge of derivative proceedings but placed a balance between the company and shareholders by stating that shareholders would be able to file proceedings in 'exceptional circumstances'.[74]

A. The Resemblance of the *Foss* Rule to Qatari Company Liability Actions

There are great differences in the legal origins in the two countries. The UK legal system is based on common law, in which the doctrine of *stare decisis* and judicial precedents are the cornerstone of the development of legal doctrines, whereas, in contrast, Qatar is known to be a civil law legal system where the judge's role is narrowly limited to applying the statute without rendering modifications to the provision or creating new or adding new precedents that legally bind other judges. The main role in the legal development is linked to the legislative body represented by parliament (which in Qatar is called the Shura Council).[75]

Despite these differences, the deeply rooted issues of shareholders' remedies under *Foss* resemble the Qatari problem of company liability actions in three axes.

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[70] Yohana Gadaffi and Miriam Tatu, Derivative Action under the Companies Act 2015: New Jurisprudence or Mere Codification of Common Law Principles, Strathmore Law Journal, Volume 2, Issue 1, November 2016, at 80.

[71] *Id.*

[72] Law Commission, Shareholder Remedies (Law Com CP No 142, 1996) (LC Consultation Paper) para 1.21.

[73] *Id.* para 1.4.

[74] *Id.* para 6.5.

[75] Shura Council Law No. 7 of 2021.

First, the company's role as a separate legal entity is narrowly limited in the protection of minority shareholders. In both jurisdictions, the company's decision to file legal proceedings is confined the power of the GM of shareholders.[76] In other words, as the company is a nexus of contract, and shareholders are the supplier of the company's capital and holders of company's shares, shareholders have the capacity to discuss the possibility of filing a claim in the name and benefit of the company. According to the doctrine of shareholder democracy, shareholders must have an active ownership and role in the company to influence on its decision-making and strategic planning.

However, the excess of shareholder democracy doctrine seems to be detrimental to shareholder activism in the CG of Qatari publicly held companies, as the landscape of the corporate ownership structure is concentrated and families and the government play a key role in shaping the decision-making process and idiosyncratic vision of the company's future. Delving deeper, ownership and control are not separated, and the controlling shareholder is present in the control and daily operation of the company. As a result, minority shareholders cannot avail themselves of GMs, and potential changes, and their votes cannot match the formidable power of the controlling shareholders.

The result indicates that Qatar lacks the procedural and substantive legal means to support a litigious environment for minority shareholders against controlling shareholders as a last-resort solution. In fact, the system of company liability action has been constructed to be unproductive and inoperative owing to the unnecessary procedural hurdles, from sending an invitation to call a GM to the deliberation of such a matter under the supervision and control of controlling shareholders. As a result, the role of the company, as a separate legal entity, is confined to the discretion of controlling shareholders and the ownership structure.

Second, while the model of shareholder primacy[77] seems to be popular in Anglo-American legal systems, where shareholder activism is paramount to the dynamism of CG and monitoring purposes,[78] Qatar tends to lean towards

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[76] Edwin Mujih, The New Statutory Derivative Claim: A Delicate Balancing Act: Part 1, The Company Lawyer, Volume 33, Issue 3, March 2012, at 77.

[77] The paradigm of shareholder primacy (otherwise known as shareholder wealth maximization and shareholder value movement) refers to a tenet endorsed by shareholders who believe that company must put shareholders' interests first and above any other costs such as labour, climate change and corporate social responsibility in order to maximize the wealth of shareholders' capital in the company. See Judd Sneirson, 'The History of Shareholder Primacy, from Adam Smith through the Rise of Financialism' in Beate Sjåfjell and Christopher Bruner (eds), The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability, 1st edition, Cambridge University Press, UK, 2019, at 73–85.

[78] Paul Andersen and Evelyne Sørensen, 'The Principle of Shareholder Primacy in Company Law from a Nordic and European Regulatory Perspective' in Birkemose and others (eds), The European Financial Market in Transition, 1st edition, Kluwer Law International, UK, 2012, at

majority control interest and the UK tends to favour the management approach position. The former provides legal remedies that fit the requirements of majority shareholders – in other words, the mechanics of company liability action have been designed to be used not by minority but by majority shareholders – whereas the latter expressed its perspective that new statutory derivative must be used in 'exceptional circumstances'[79] and derivative claims must not be promoted where a claimant lacks solid *locus standi* and cannot demonstrate valid evidence to the court.[80]

B. The Advent of Statutory Derivative Claims in the Companies Act 2006

In 2006, Chapter 11 of the new Companies Act 2006 (the Act) introduced a new procedural and substantive legal framework for derivative claims. The Act aimed to provide a flexible, resilient and cost-efficient litigious environment for minority shareholders against wrongdoers. Chapter 11 broadened the legal grounds for filing a claim. Under the new Act, claimants are entitled to file claims based on causes of action arising from an actual or proposed act or omission involving negligence, default, breach of duty or breach of trust by a director of the company.[81] It can be observed that directors' negligence is a ground to hold directors liable where in common law 'negligence or error of judgment' was not a cause of action for shareholders.[82]

However, in order not to disturb management with malicious claims and to protect the ability to attract talented directors to the company, a threshold was imposed to prevent misuse of the claim. Therefore, a claimant preparing to file a derivative claim against alleged wrongdoers must pass two stages.

First, the so-called '*prima facie*' stage, where a claimant advocates before the court alone, without the presence of the wrongdoers, to provide their legal documents and valid evidence. The legislative background of this stage is to filter out hopeless cases at an early stage without draining the company's financial resources.[83] As a result, the claimant is in a critical situation as the burden of proof is upon them to support their allegations with solid evidence, otherwise the court will refuse the claimant permission to continue the claim.[84]

170–73.

[79] Law Commission, Shareholders Remedies, Consultation Paper No.142 (1996), para.4.6

[80] Edwin Mujih, The New Statutory Derivative Claim: A Delicate Balancing Act: Part 1, The Company Lawyer, Volume 33, Issue 3, March 2012, at 78.

[81] The UK Companies Act 2006, s 260 (3).

[82] Shaowei Lin, Derivative Actions in the UK: Revised Yet Unimproved - Image about Derivatives Market, King's Student Law Review, Volume 4, Issue 1, September 2013, at 28.

[83] Qamarul Jailani, Derivative Claims under the Companies Act 2006: In Need of Reform?, UCL Journal of Law and Jurisprudence, Volume 7, Issue 2, 2018, at 79.

[84] *Wishart v Castlecroft Securities Ltd* 2010 S.C. 16 [31]

The court has discretion, if no *prima facie* cause is demonstrated by the claimant, to dismiss a claim and issue a consequential order such as costs or an order restraining a party from bringing proceedings.[85]

A derivative claim will be heard at the second stage once the court has allowed the claimant to continue and if the claim has merit. The court, in the second stage, enjoys wide discretion based on several factors to assess the claim and claimant. It is mandatory for the court to assess the claim under the conditions listed in Section 263 of the Act. If it is *prima facie* valid, the court may grant permission to the claimant and defendant to proceed to a hearing, refuse permission, or adjourn the claim. The court is obliged to take into consideration, when assessing the claim, numerous factors:

> Whether the member is acting in good faith in seeking to continue the claim;
> the importance that a person acting in accordance with Section 172 (duty to promote the success of the company) would attach to continuing it;
> where the cause of action results from an act or omission that is yet to occur, whether the act or omission could be, and in the circumstances would be likely to be—
> authorised by the company before it occurs, or
> Ratified by the company after it occurs;
> where the cause of action arises from an act or omission that has already occurred, whether the act or omission could be, and in the circumstances would be likely to be, ratified by the company;
> whether the company has decided not to pursue the claim;
> whether the act or omission in respect of which the claim is brought gives rise to a cause of action that the member can pursue in his own right rather than on behalf of the company.

The second stage is conceivably where many proceedings fail, owing to the wide discretion conferred on the court. For example, Section 172 expects directors to promote the success of the company. While section 172 had a fair share of academic arguments especially related to the interpretation and application of the word 'success', the court's wide discretion may permit it to dismiss the claim. William Trower QC listed several factors to be considered before dismissing the claim, including 'the prospects of success of the claim, the ability of the company to make a recovery on any award of damages, the disruption which would be caused to the development of the company's business by having to concentrate on the proceedings, the costs of the

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[85] James Kirkbride, Steve Letza and Clive Smallman, Minority Shareholders and Corporate Go vernance: Reflections on the Derivative Action in the UK, the USA and in China, Internation al Journal of Law and Management, Volume 51, Issue 4, January 2009, at 210.

proceedings and any damage to the company's reputation and business if the proceedings were to fail'.[86]

The current shape and framework of derivative claims are rooted and reflected in the case law rules of the 19th century, which are seen as out of touch with the urgent need for a contemporary corporate and business environment.[87] As argued by Boyle, there is a common understanding from judiciary and common law commissions that it is unfavourable to allow a deluge of claims by minority shareholders in public listed companies.[88] The driving force for leaning towards corporations is related to their size, massive capital and their importance to the economy and financial markets.[89] In other words, opening the door to minority shareholders to file judicial proceedings may undermine the reputation of large companies. Boyle's and Reisberg's arguments reflect the Law Commission's report and consultation paper, in which it insisted that derivative claims must be contingent on 'tight judicial control'[90] in the first and second stages and filing derivative claims is an exception to the principal route, which is that a wrong must be cured by shareholders within the company's ambit.

VI. Analysis and Findings

The current framework of CG strategies has reflected the weak position of minority shareholders. First, the role of the minority shareholder has been undermined by the fact that company liability actions disregard their presence as shareholders. Controlling shareholders' immunity to claims paves the way for them to engage in illicit practices against the company's interests. The inevitable outcome is the absolute control of a single dominant perspective on wealth over the minority interests. Second, the structure of company law is supposedly to weaponize shareholders with checks and balances. For example, GMs are entitled to oversee the behaviours of controlling shareholders and directors. However, owing to the absence of a role for the company and the unmatched powers between controlling and minority shareholders, minority shareholders have no interest in attending GMs. The situation in Qatar is also a bit complex because it is a common pattern for a single shareholder, either a family or the government, to hold more than 50% of the company's shares.

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[86] *Franbar v Patel* [2008] EWHC 1534 (Ch) [36].

[87] Arad Reisberg, Theoretical Reflections on Derivative Actions in English Law: The Represen tative Problem European Company and Financial Law Review, Volume, 3, Issue 1, March 20 06, at 70.

[88] AJ Boyle, Minority Shareholders' Remedies, at 12, 1st edition, Cambridge University Press, UK, 2002.

[89] *Id.*

[90] Law Commission, Shareholder Remedies (Law Com CP No 142, 1996) (LC Consultation Paper) para 6.6.

Third, company liability actions have been designed to be functional not to minority shareholders but to controlling shareholders. As a result, it is highly unexpected that controlling shareholders will file a claim in the name of the company against their interests or appointee.

The ingrained problems are related directly to the combination of power and wealth enjoyed by political families and the government in the shaping of CG culture, strategies and practices. The conflicted interests on the QSE have undermined the effective remedies available to minority shareholders as families and the government are key players on the QSE, generating profits on its investments. In other words, strong substantive and procedural safeguards in CG will constrain the freedom and ability of controlling shareholders' dealings and RPTs with the company.

This argument is supported by the fact that recent amendments to corporate law[91] have overlooked the urgent need to modify the core aspects of company liability actions. In fact, from the first inception of corporate law to its latest amendments, Qatari corporate law has taken no notice of the imperative role of company liability actions on the rights of shareholders. A combination of factors has locked the path of corporate law development to favour the interest of key parties and neglect others, such as politics, culture and the rule of law. Accordingly, the Doing Business report of 2020 ranked Qatar's minority shareholder protection remedies as one of the weakest of all countries, ranking Qatar 157th, with score of 2 out of 10, compared to an OECD average score of 7.[92]

A. Suggestions

As a general rule, this research urges lawmakers in the state of Qatar to urgently amend article 115 of the QCL. Amendments must include the repeal of the approval threshold at GMs. A shareholder must be able to file a company liability action on behalf of and in the name of the company against wrongdoers. It is strongly believed that, once amendments are implemented, shareholders' activism will be at its peak, and directors will be cautious about entering into RPTs. However, in order to avoid any prejudice by shareholders against directors' decision-making, some threshold is suggested.

Since shareholders, after suggested amendments, can file the claim without approval from the GM, this research suggests the transplantation of the *prima facie* rule only from the UK legal system. This rule allows shareholders

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[91] Law No. 8 of 2021 amending some provisions of the Commercial Companies Law by Law No. (11) of 2015.

[92] World Bank, 'Ease of Doing Business' (2018–2020) <https://archive.doingbusiness.org/en/data/exploreeconomies/qatar#DB_pi> accessed 18 February 2023.

to gauge their claim seriously before the initiation of judicial proceedings. It allows the commercial judge, without the presence of directors, to assess the credibility and strength of *locus standi* once the claim is filed. Thus, if the commercial court believes that the claim has merit, it can allow the second party, the directors, to respond to the claim, otherwise dismissal of the claim is inevitable. The main purpose of the *prima facie* rule is to filter out malicious claims and to ensure that the corporate environment is always attractive for competent directors.

VII. Conclusion

This article has highlighted the key aspects of shareholders remedies represented in company liability actions. In comparison with UK derivative claims, the Qatari company action model shows a resemblance to the old *Foss v Harbottle* rule: both tend to block unmeritorious claims; however, they undermine the position of minority shareholders to pursue claims in the name of the company. However, the UK derivative claims have undergone major modification in the CA 2006. Minority shareholders are able to file UK derivative claims with no pre-filing conditions but certain restrictions such as having a *prima facie* case have been imposed to ensure that overuse is contained. The Qatari position has not been changed since the first inception of corporate law, and minority shareholders still suffer from a lack of adequate safeguards against controlling shareholders. The substantive and procedural safeguards need urgent amendment to reflect a positive perspective on international reports such as the Doing Business report. The claim has been designed to be dysfunctional for minority shareholders as it requires approval by a GM dominated by controlling shareholders.

Finally, the consequences of not developing shareholder remedies in Qatar are severe, as corporate law seems to be unfriendly to shareholder activism in the company, and a lack of litigation culture hinders the rights of minority shareholders. It can thus be easily understood that the role of institutions in the development of capital markets to steer shareholders' rights in a certain direction is underdeveloped. Qatar currently stands in need of a shareholders' association that does not exist. With the increase of company upheaval and with aspects of shareholders activism purely represented by claims initiated by shareholders, the attractiveness of the QSE to new capital is challengeable.

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Chinese Legislation in Employment Termination and Employment Discrimination: Suggestions for Improvement

A Comparison between the United States and China

*Qing Sun**

ABSTRACT

This paper compares the employment termination laws and the laws against employment discrimination in China to the same type of laws in the United States, explores the cultural reasons behind Chinese laws, and then discusses the problems and feasible solutions regarding China's employment termination laws and the laws against employment discrimination with special attention to laws enacted in China's new Civil Code against sexual harassment. China should boost the democratic participation of employees in the corporate process of making rules and regulations. With regard to the employment termination laws, both parties to a fixed-term employment contract should be bound by the duration, while the law should reduce the strict requirements for legal discharge. In terms of laws against employment discrimination in China, the present degree of public awareness and cultural shift is not sufficient for a comprehensive overhaul. However, in relation to the current issue of sexual harassment in the workplace, the law should clarify and expand the definition of sexual harassment and clarify the employer's liability, while lowering the burden of proof in sexual harassment cases.

KEYWORDS: employment termination, employment discrimination, democratic participation of employees, sexual harassment, command-and-obedience model

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INTRODUCTION

Due to the different philosophies of employment law in China and the United States, each country has developed a different set of rules regarding employment termination and anti-discrimination in employment. This paper examines the differences between China and the U.S. in employment termination laws and employment discrimination laws, explores the cultural reasons behind Chinese laws, and discusses both the problems with these laws in China and feasible solutions to them.

I. A COMPARISON OF THE EMPLOYMENT TERMINATION LAWS AND THE LAWS AGAINST EMPLOYMENT DISCRIMINATION IN THE U.S. AND IN CHINA

Currently, the United States is the world's largest economy and China is the second largest economy. Both countries are active participants in international trade and both have great influence on the global economy. However, the two countries have many differences in terms of ideology, legal systems, and legal cultures. On one hand, multinational companies can compare U.S. and Chinese employment laws to understand the laws they need to follow when firing employees in both countries and the compliance issues they should

be aware of when it comes to employment discrimination. On the other hand, the Chinese government can compare the U.S. and Chinese laws in the same areas to gain a better understanding of the parts of U.S. law that are helpful to China, and thus provide suggestions on how to solve existing problems with China's current employment termination laws and employment discrimination laws to achieve the goal of more efficient and harmonious labor-management relations.

A. Laws Governing Employment Termination

The termination of an employment contract in China is illegal if it doesn't follow the laws. [1] To be a legal termination, the termination must fall squarely into one of the legally approved categories. If it doesn't, then it is illegal. The legal termination of employment contracts in China can be divided into the following categories: negotiated termination by both parties, unilateral termination by the worker (resignation), and unilateral termination by the employer (including termination due to employee's negligence, termination where employees are not at fault, and economic redundancy).[1] Unlike the U.S. employment-at-will doctrine, under the framework of China's employment contract law, the employer is required to pay economic compensation for a significant portion of legal terminations. [2] For example, for a negotiated termination proposed by an employer, the employer is required to pay economic compensation. In the case of unilateral termination by the employee, the employer is required to pay economic compensation if the employer is at fault (constructive dismissal). In the case of unilateral termination by the employer, unless the worker has seriously violated the corporate rules and regulations or other limited circumstances arise, the employer is still required to pay economic compensation. In addition, when a fixed-term employment contract expires, the employer is also required to pay economic compensation, except when the employer wants to renew the contract and the worker refuses to do so. The amount of economic compensation is calculated by multiplying the average wage of the 12 months prior to the worker's departure by the number of years of employment.[3]

China's Employment Contract Law enumerates the limited circumstances mentioned above for legal termination. Although the law also states the

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[1] *See* Laodong Hetong Fa (劳动合同法) [Labor Contract Law] promulgated by the Standing Comm. Nat'l People's Cong., Jun. 29, 2007, effective Jan. 1, 2008, revised Dec. 28, 2012), art. 36–42 (China) (English translation provided by PKULAW, *available* at https://www.pkulaw.com/en_law/7ab5e7d605f859e6bdfb.html?keyword=labor%20contract%20law).

[2] *See id*. art. 46

[3] *See id*. art. 47.

prohibitions against termination of employment contracts, Article 87 of the law clearly states that termination is illegal except in explicitly stated permissible legal situations. Therefore, the termination of the employment contract will be considered illegal termination if it does not adhere to the limited provisions of the law. In case of illegal termination, the employer is required to pay compensation equivalent to twice the amount of financial compensation.[4]

The U.S. has an employment-at-will doctrine, although there are some exceptions[5]. Under the employment-at-will doctrine, both parties to an employment contract can terminate without cause and without providing compensation except in cases of wrongful discharge. Based on the legal concept of "consideration" as defined in contract law, the employer can only commit to an indefinite-term employment contract if the worker promises never to quit. However, in most cases, the worker will not guarantee an "indefinite employment contract," so, under the principle of reciprocity, the employer is not obligated to provide a contract with an indefinite period of employment either.[6] According to current U.S. common law practice, there are three main ways to avoid following the employment-at-will doctrine: 1. Express contract: One way is for both parties to explicitly agree to a fixed-term employment contract, where both parties are bound by the agreed-upon term. The other way is to include in the contract that they agree to terminate the employment contract if there is just cause. 2. Implied contract: There is evidence that both parties are unwilling to accept an employment-at-will contract. For example, there is an unspoken rule in a company that it only fires its staff in the top management with just cause.[7] Or, the company's employee handbook implies that it only terminates the employment contract with just cause.[8] 3. The worker provides

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[4] *See id*. art. 87.

[5] Nicole B. Porter, The Perfect Compromise: Bridging the Gap Between At-Will Employment and Just Cause, 87 Nebraska L.J. 62, 69-70 (2008) (Mentioning that Montana, by its 1987 Wrongful Discharge from Employment Act, repealed the employment-at-will doctrine. In addition, as the U.S. territories, the U.S. Virgin Islands and Puerto Rico also deviate from the at-will employment doctrine.)

[6] A few exceptions to this principle exist, which include but are not limited to the following situations. First, the worker sells his business to the employer in exchange for the conclusion of an indefinite employment contract. *See* Carnig v. Carr, 46 N.E. 117 (Mass. 1897). Second, the worker waives the work compensation claim in exchange for an indefinite employment contract. *See* Pierce v. Tennessee Coal, Iron & Railroad Co., 173 U.S. 1 (1899).

[7] *See* Pugh v. See's Candies, Inc., 116 Cal. App. 3d 311, 329, 171 Cal. Rptr. 917, 927 (Ct. App. 1981) (Pugh has been with the company for more than thirty years and has worked his way up from a junior employee to management. The company's unspoken rule for management employees was that they would not be terminated without good cause, and Pugh had a very good track record, yet one day he was suddenly terminated without cause. The court held that there was an implied term in this case).

[8] *See* Woolley v. Hoffmann-La Roche, Inc., 99 N.J. 284, 307, 491 A.2d 1257, 1270 (1985) (Woolley signed an employee handbook with the company, which stated that termination by the company required a specific procedure when just cause occurred, but the company ended

additional consideration, such as giving the employer an additional benefit or undergoing a substantial hardship other than his services.

In the context of the employment-at-will system described above, to protect the interests of third parties, the common law in the United States has gradually developed a set of rules regarding wrongful discharge. There are three main types of wrongful discharge in violation of public policy: 1. Discharge for an employee's refusal to commit unlawful acts, such as an employee's refusal to commit perjury in a government investigation of a company's wrongdoing. 2. Discharge for an employee's exercise of a statutory right, such as an employee's filing a claim for benefits under the workers' compensation statute. 3. Discharge for employee's fulfillment of public duty, such as serving on jury duty. 4. Some states also consider the dismissal of a whistleblower to be a wrongful discharge as well. That is, the employee reports the company's unlawful conduct to a supervisor or outside agency.[9]

B. Laws Against Employment Discrimination

A. China does not have a specific act or code against employment discrimination. Rather, it is addressed within a variety of laws including the Employment Promotion Law, the Labor Law, the Labor Contract Law, the Law on the Protection of Women's Rights and Interests, and the Law on the Protection of Disabled Persons, which provide general provisions on equal employment, anti-discrimination, and equal pay for equal work. For example, Article 3(2) of the Employment Promotion Law states, "Workers shall not be discriminated against in employment on the basis of ethnicity, race, gender, religious beliefs or any other similar form of discrimination." This article is open-ended on the types of employment discrimination. Nevertheless, the relevant discrimination laws are silent on the definition of discrimination, its manifestations, and the burden of proof in discrimination cases. Only Article 62 of the Employment Promotion Law provides that employment discrimination can be a cause of action, but there are no specific guidelines for how to make a claim.[10] China's employment discrimination laws do not address discrimination based on age, appearance, and sexual orientation. Family responsibility discrimination is not mentioned, nor are affirmative action cases and retaliation cases. For sexual harassment, it is worth noting that

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up terminating him outright. The court held that if an employee handbook provides for just cause, the employer is required to comply).

[9] *See* STEVEN L. WILLBORN ET AL., EMPLOYMENT LAW CASES AND MATERIALS 138 (6th ed. 2017) (discussing the typology of wrongful discharge cases).

[10] *See* Jiuye Cujin Fa (就业促进法) [Employment Promotion Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 31, 2007, effective Jan. 1, 2008, revised Apr. 24, 2015), art. 62 (China) (English translation provided by PKULAW, *available* at https://www.pkulaw.com/en_law/1e8e09abdbcff012bdfb.html).

the Civil Code, which took effect in 2021, incorporates the topic of sexual harassment. Its article 1010 stipulates that "A person who has been sexually harassed against his will by another person through oral words, written language, images, physical acts, or the like, has the right to request the actor to bear civil liability in accordance with law. The State organs, enterprises, schools, and other organizations shall take reasonable precautions, accept and hear complaints, investigate and handle cases, and take other like measures to prevent and stop sexual harassment conducted by a person through taking advantage of his position and power or a superior-subordinate relationship, and the like."[11] The Civil Code describes several forms of sexual harassment, clarifies legal liability, and describes the obligations associated with employers. This is a milestone in China's anti-sexual harassment law.

B. Compared to the U.S., the Chinese government plays a more active role in addressing disability discrimination within China's employment discrimination framework. Article 52 of the Employment Promotion Law provides that for people with employment difficulties, the government "shall establish and improve the employment assistance system, adopt tax exemptions, loan subsidies, social insurance subsidies, job subsidies, and other methods, and implement priority support and focused assistance for people with employment difficulties through public welfare job placement and other means." This is a kind of overall subsidy for the disadvantaged groups in employment. At the same time, Article 55 is about providing jobs to people with disabilities. Governments at all levels shall take measures to support it. Articles 8 and 9 of the Regulations on Employment of Persons with Disabilities further stipulate that for most enterprises, the proportion of employment arranged for persons with disabilities shall not be less than 1.5% of the total number of employees on duty. If the enterprise can achieve the quota, it can enjoy tax benefits; if not, it must pay the employment guarantee fee for the disabled. Article 10 stipulates that the government and social organizations will set up welfare enterprises for the disabled, blind massage institutions, and other programs.[12] Within the framework of Chinese law, the Chinese government has taken a positive governmental function, while stimulating social participation, to promote the employment of disadvantaged groups, rather than having the judiciary "correct" individual cases of discrimination.

C. The positive role of Chinese government laws and regulations in

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[11] *See* Minfadian (民法典) [Civil Code] (promulgated by the Nat'l People's Cong., May 18, 2020, effective Jan. 1, 2021), art. 1010 (China) (English translation provided by Nat'l People's Cong.)

[12] *See* Jiuye Cujin Fa (就业促进法) [Employment Promotion Law] (promulgated by the Standing Comm. Nat'l People's Cong., Aug. 31, 2007, effective Jan. 1, 2008, revised Apr. 24, 2015), art. 10 (China) (English translation provided by PKULAW, *available* at https://www.pkulaw.com/en_law/1e8e09abdbcff012bdfb.html).

protecting female workers is also reflected in the Law on the Protection of Women's Rights and Interests[13] and a series of other government regulations, especially for female workers during the "three periods": pregnancy, maternity and breastfeeding period. 1992 saw the adoption of the Law on the Protection of Women's Rights and Interests by the National People's Congress and its implementation in the same year. Article 48 of it stipulates that no employers may reduce the wages of a female employee, dismiss a female employee, or unilaterally terminate an employment contract because of marriage, pregnancy, maternity leave, breastfeeding, or other circumstances. If the female employee resigns or proposes her own termination, these protections do not apply.

At the level of administrative regulations, the State Council promulgated the Special Provisions on Labor Protection for Female Workers in April 201214, which states in Article 6, paragraph 1, "If a female worker cannot handle the work she was previously expected to do, based on the certificate from a doctor, her employer must assign her less work or other work that she is able to do." Paragraph 2 stipulates, "If a female worker has been pregnant for over 7 months, her employer cannot ask her to work longer hours or at night. In addition, her employer must provide her with a break during regular working hours." Paragraph 3 stipulates, "The time needed to get prenatal care during the workday must be considered as hours worked." Article 7 specifies the maternity leave that female workers can take, stating, "A female worker is entitled to 98 days of maternity leave, 15 days of which may be taken before childbirth. If childbirth is difficult, she is entitled to 15 additional days. If there is a multiple birth, the worker may take an extra 15 days per additional child." For breastfeeding female workers, the provisions of Article 9, paragraph 1 state, "Employers cannot ask female workers who are breastfeeding a baby younger than one year old to increase the hours of their workday or to work the night shift." Article 2 states, "The employer must provide one hour within the workday for female workers to breastfeed their baby. In the case of multiple births, the female worker is entitled to another hour of breastfeeding time for each additional child within each workday."

D. To support the three-child policy, local regulations in several provinces have even increased the number of days of maternity leave available to female workers, and added nursing leave for spouses, providing humane opportunities for new fathers to care for their babies and adapt to their new roles. For example, in 2021, the Standing Committee of the Shanghai Municipal People's Congress

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[13] *See* Funü Quanyi Baozhang Fa (妇女权益保障法) [Law on the People's Republic of China on the Protection of Women's Rights and Interests] (promulgated by the Nat'l People's Cong., Apr. 3, 1992, effective Oct. 1, 1992, revised Oct. 30, 2022) (China).

[14] *See* Nüzhigong Laodong Baohu Tebie Guiding (女职工劳动保护特别规定) [Special Provisions on Labor Protection for Female Workers] promulgated by the St. Council, Apr. 28, 2012, effective Apr. 28, 2012) (China) Translated by Qing Sun (English)

amended Article 31, paragraph 2 of the Shanghai Regulations on Population and Family Planning, which states that for couples who give birth in accordance with the laws and regulations, the female partner will have sixty days of maternity leave in addition to the maternity leave provided by the state, and the male partner will have ten days of paternity leave.[15] Thus, it can be seen that the rights and interests of female workers to take leave during pregnancy and childbirth are systematically guaranteed not only under the national policies, but also under a variety of local policies incentivized by the national policies.

E. The beginnings of employment discrimination laws in the United States originated in Title VII of the Civil Rights Act, followed by the Age Discrimination in Employment Act (ADEA), the Americans with Disabilities Act (ADA), the Equal Pay Act, and the Family Medical Leave Act (FMLA). The traits protected by employment discrimination laws include not only ethnicity, race, gender, religious beliefs, and national origin, but also age, physical appearance, sexual orientation, and family responsibilities. Generally, a potential plaintiff must file a charge with the Equal Employment Opportunity Commission (EEOC) within 180 days of an alleged discriminatory event. It can be extended to 300 days if a state or local agency enforces a law prohibiting employment discrimination on the same basis.[16] EEOC also has 180 days for investigation. If the EEOC determines that there is probable cause, but conciliation is not possible, it may bring a suit or issue "a Notice of Right to Sue". If the EEOC determines that there is no probable cause, it may issue "a Notice of Right to Sue " directly.[17]

F. The U.S. model of employment discrimination liability can be divided into several theories. The main theories are individual disparate treatment, systemic disparate treatment, disparate impact, sexual harassment, retaliation and failure to provide accommodations to special populations such as religious people and the disabled.

G. Individual disparate treatment discrimination refers to the cases where the employer makes an adverse employment action with his intent to discriminate against an individual worker. As for the burden of proof, after the employee makes out a prima facie case, the employer is required to articulate some legitimate nondiscriminatory reason (LNR) as a rebuttal. Then the

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[15] *See* Shanghai Shi Renkou Yu Jihua Shengyu Tiaoli (上海市人口与计划生育条例) [Shanghai Regulations on Population and Family Planning] (promulgated by Shanghai Municipal People's Congress Standing Comm., Dec. 31, 2003, effective Apr. 15, 2004, revised Nov. 25, 2021) art. 31, para. 2 (China)

[16] *See* U.S. Emp. Equal Opportunity Comm'n, *Time Limits for Filing a Charge*, U.S. EMP. EQUAL OPPORTUNITY COMM'N, https://www.eeoc.gov/time-limits-filing-charge (last visited Jun. 8, 2023)

[17] *See* U.S. Emp. Equal Opportunity Comm'n, *What You Can Expect After You File a Charge*, U.S. EMP. EQUAL OPPORTUNITY COMM'N, https://www.eeoc.gov/what-you-can-expect-after-you-file-charge (last visited Jun. 8, 2023).

employee should prove that the employer's reason for discrimination is a pretext.[18]

H. Systemic disparate treatment discrimination involves a standard operating procedure for a group of employees, which can be further divided into facially discriminatory policy and a discriminatory pattern and practice.[19]

I. A facially discriminatory policy is one in which the employer has a policy that is clearly detrimental to a protected group of employees. For example, because a significant percentage of their male prisoners who were sexual violators were located in different dormitories within the prison, an Alabama prison set a high requirement of the height and weight of the female applicants for the position of correctional counselor due to safety concerns for female employees.[20] For allegations of discrimination against female workers, the employer must prove that the requirement is a "bona fide occupational qualification (BFOQ)". In order to prove BFOQ, the employer must prove that the occupational qualification is reasonably necessary to the essence of the business. On top of that, the prohibited classification must be a proxy for an occupational qualification. It means basically everyone or substantially all persons in the class will be unable to perform the job or it's impossible to distinguish between them.[21]

In the case of discriminatory patterns and practices, in the first phase, the employee is required to prove with statistics and testimonials that the pattern or practice contains the intention to discriminate. Then the employer may rebut it by giving a different interpretation of the evidence.[22] If the discriminatory pattern and practice are established, in the second phase, the individual employee will need to prove that he applied for the job or would have applied for the job were it not for discrimination on the premise that he had the minimum qualifications. Then, the employer will need to disprove the presumption of discrimination against each plaintiff. [23]

Disparate Impact Discrimination: Unlike disparate treatment discrimination, disparate impact discrimination does not require discriminatory

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[18] *See* McDonnell Douglas Corp. v. Green, 411 U.S. 792, 93 S. Ct. 1817, 36 L. Ed. 2d 668 (1973).

[19] *See* SULLIVAN ZIMMER, CASES AND MATERIALS ON EMPLOYMENT DISCRIMINATION 93 (9th ed. 2017).

[20] *See* Dothard v. Rawlinson, 433 U.S. 321, 97 S. Ct. 2720, 53 L. Ed. 2d 786 (1977).

[21] *See id.*

[22] *See* E.E.O.C. v. Sears, Roebuck & Co., 839 F.2d 302 (7th Cir. 1988) (in a company where men were concentrated in higher paying sales positions paid on a commission basis and women were concentrated in lower paying sales positions paid on an hourly basis, the EEOC provided statistical evidence of the company's pattern and practice of discrimination, which the company rebutted: First, commission sales are very different from non-commission sales; Second, the women are less interested in commission sales than men; Third, the women are less qualified for commission sales than men).

[23] *See* Int'l Bhd. of Teamsters v. United States, 431 U.S. 324, 97 S. Ct. 1843, 52 L. Ed. 2d 396 (1977)

intent, but rather seeks to eliminate a particular employment practice that adversely affects a group of employees protected by discrimination laws. The employee is required to prove that a facially neutral employment practice has a disparate impact on a disadvantaged group. The employer, in turn, is required to prove that the practice is consistent with business necessity. [24]

Sexual harassment is any unwelcome sexual behavior that unreasonably interferes with an individual's work performance or creates an intimidating hostile or offensive work environment.

Retaliation happens when the employers unfairly treat the employee through termination of the contract, demotion and other retaliatory actions that are unfair to the employee, when the employee files a complaint of discrimination, participates in an investigation or lawsuit, or opposes discriminatory practices. If retaliation can be proven by employees, employees can also get compensation.

The employment discrimination law requires employers to accommodate religious issues as long as it does not cause the employer undue hardship. [25]When it comes to people with disabilities, we should consider whether the worker is a qualified worker, and then consider whether the worker has suffered discrimination. A qualified worker is an individual who has the skills, experience, and education required for a particular position and who can perform the essential function of the work with or without reasonable accommodation by the employer. A qualified employee is discriminated against if he or she is treated differently than others or if he or she is not accommodated reasonably unless there is an undue hardship for the employer.[26]

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[24] *See* Griggs v. Duke Power Co., 401 U.S. 424, 91 S. Ct. 849, 28 L. Ed. 2d 158 (1971) (A company had five departments, the labor department of which was underpaid and composed primarily of blacks. The company enacted a rule that a high school diploma or other test was required to transfer to other departments (inadvertently excluding all labor department blacks from transferring). The court held that the EEOC's guidelines, which interpret Title VII, Section 703(h) as "permitting only job-related tests", were consistent with the intent of the Congressional legislation. As for good employer intent, it does not undo the discriminatory effect of unfair testing.").

[25] *See* E.E.O.C. v. Abercrombie & Fitch Stores, Inc. 575 U.S. 768, 135 S. Ct. 2028, 192 L. Ed. 2d 35 (2015) (Company's failure to hire applicant because she wore a Muslim headscarf in violation of the company's dress code constituted discrimination.)

[26] *See* E.E.O.C. v. Picture People, Inc. 684 F.3d 981 (10th Cir. 2012) (An employee's job duties at a studio were to direct children in poses, and because of her disability and inability to speak, she relied on written instructions, gestures, and mime to communicate with customers. Photography time was limited to 20 minutes, and her disability made the job difficult, so the manager reassigned her to a job developing photographs. The court found that communication skills were important in this job and that, under the ADA, employers are not required to hire or retain employees who are unable to perform essential job functions, regardless of reasonable accommodations).

Ⅱ. UNDERLYING REASONS BEHIND CHINESE EMPLOYMENT TERMINATION LAWS AND EMPLOYMENT DISCRIMINATION LAWS

A Chinese scholar, Yang Haonan, dissects the real reasons behind the differences in the termination protection laws in China and the United States. [27] He argues that although the U.S. has an employment-at-will doctrine, employers are still constrained by the following six restrictions: First, the constraints of labor supply and demand. By comparing the unemployment rates in China and the United States, he explains that there is a large amount of labor in rural China to show that the labor market in China has greater supply than demand, while the labor market in the United States is just the opposite. The second is the constraint of the market economy mechanism on wrongful dismissal. He argues that in a country with a developed market economy like the United States, employers are relatively rational, so they tend not to fire employees hastily. The third is the constraint of social media. He believes that information pluralism in the U.S., that idea that the people in the U.S. have access to multiple sources of information, constitutes public opinion pressure on illegal dismissals, while the social media in China is reluctant to report sensitive events, resulting in a lack of restraint on employers. Fourth is the constraint of religious moral standards. He argues that Americans tend to behave more morally because much of the population is Christian, while the lack of religious moral constraints during China's socio-economic transition has led to selfishness and self-interest among the Chinese people. Fifth is the constraint of collective contracts. He argues that while the number of collective contracts in which the employees are represented by trade unions is shrinking in the United States, Chinese labor unions are simply unable to defend the legal rights of workers, making collective contracts completely unenforceable. Sixth is the constraint of the legal system itself. He believes that although the employment-at-will doctrine in the United States has a lenient behavior pattern, the consequences are much more serious once the employee is discharged in violation of the law compared to China.

I believe that a valid analysis of labor supply and demand cannot be conducted simply by comparing the unemployment rates in China and the United States while measuring the influx of surplus labor from rural areas to

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[27] *See* YANG HAONAN (杨浩楠), WANSHAN WOGUO JIEGU BAOHU FALÜ ZHIDU DE SILU HE DUICE – JIYU ZHONGMEI JIEGU BAOHU JIZHI DE BIJIAO (完善我国解雇保护法律制度的思路与对策 ——基于中美解雇保护机制的比较)[Ideas and Solutions for Improving the Legal System of Dismissal Protection in China - A Comparison of Dismissal Protection Mechanisms in China and the United States], FAXUE (法学) [L. Sci.] No.3, 2016, 60–70.

cities in China. A microeconomic conclusion should only be drawn after defining a specific period of time, a specific industry and a specific research scope. However, it is undeniable that the large labor force in China often gives employers the impression that there is an abundant supply of labor, even though quality labor may not be found quickly. This impression has a significant negative effect on employees: Chinese employers tend to think that if they fire an employee, they can easily find a replacement for the vacancy. In addition, religious and cultural differences have an effect on the countries' job protection policy. For example, in China, the Buddhist and Taoist theories of karma hold that social status and wealth situations in this life originate from causes in the previous life and that actions in this life constitute causes of social status and wealth situations in the next life.[28] According to their theories, the main component of religious practice in this life is to abstain from desires: accept the social status of this life and do the work that is expected of one well in order to create a better afterlife. Such religious ideas cater to the needs of those in power. Instead, if a person holds the attitude that the society is unfair, people around that person will tend to feel that the person is not grounded and at the same time brings trouble for the power holder. Once those around them perceive that the advocate of justice is a problem for the power holder, they are more likely to stay away from that person, even if they know in their hearts that he is right.

When it comes to the secular world, in my opinion, there is a deeper reason behind Chinese job protections: the command-and-obedience model of reciprocal benefit-exchange behavior in a hierarchical society.

The command-and-obedience model of reciprocal benefit-exchange behavior is a distorted version of Confucianism that has been used to extremes by the ruling class in the secular world for a long time and is not Confucianism itself. Confucianism seeks to regulate emotions through rituals and to cultivate noble virtues and sentiments, thus achieving a state of mind of "harmony."[29] In addition, Confucianism also emphasizes that subordinates should be loyal to their superiors and that superiors should love their subordinates. Confucianism is an idealized set of models, and Confucius never said that the powerholder could do whatever he wanted to do. However, Confucianism, which had been used by the feudal dynasties since the Han Dynasty, was gradually distorted into a "moral" code of obedience in real society because it was combined with the interests of the rulers. This obedience is like the relationship between young

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[28] *See* Zhengfa Nianchu Jing (正法念处经) [Saddharma-smrty-upasthana-sutra], http://ccbs.ntu.edu.tw/BDLM/sutra/html/T17/T17n0721.htm (last visited Jun.10, 2023).
("非異人作惡， 異人受苦報。自業自得果，眾生皆如是。" [Not a different person commits evil, a different person suffers; self-inflicted karma, all beings are like this.")]) (last visited April 30, 2022)

[29] Confucius, The Analects, CHINESE TEXT PROJECT, https://ctext.org/liji/zhong-yong/zh (last visited Jun.10, 2023). ("Confucianism seeks to regulate the emotions through rituals and to cultivate noble virtues and sentiments, thus achieving a state of mind of "harmony")

children and their elders: young children are rewarded by their elders through obedience, and young children are "domesticated" or more accurately, socialized, for educational purposes. Similarly, in a social hierarchy, lower-status individuals are rewarded for obedience by higher-status individuals, and higher-status individuals order the lower-status individuals for purposes such as satisfying their desire for dominance. In this way, higher-status individuals and lower-status individuals satisfy each other's needs and exchange benefits through conditional benevolence and obedience. Under a derivation of this model of supply and demand, a network of relationships, either explicit or implicit, is gradually established between people in this way, and completely replaces or partially replaces law as the real channel of benefit exchange. In contract law, considerations for both parties are clear and above-board. In contrast, under the command-and obedience model, considerations are vague and implicit. The command-and-obedience model, being based on an emotional model and rooted in psychological needs, greatly undermines the ability to think independently and rationally. While the same interpersonal network exists in the United States, Americans are usually aware of its limitations in terms of the legal system.[30]

Moreover, because of its large population, China suffers from collective action problems, as does Berle-Means corporations. The large Chinese population is like the decentralized shareholders in a Berle-Means corporation, and the Chinese government is like the corporate management. In the Berle-Means model of corporate structure, it is costly for individual shareholders to search for information and then vote, and "any one shareholder's prospective share of the potential benefit that informed vote might produce would probably not justify her personal costs."[31] Moreover, "any one shareholder's vote is quite unlikely to affect the outcome of the vote", so this structure leads to a lack of interest of individual shareholders in participating in management, resulting in "rational apathy."[32] By the same token, in China, at the national level, citizens are not interested in politics and are unable to monitor the government. This in turn reinforces the command-and-obedience model of interest exchange.

In China, the command-obedience model also exists between employers and workers, and it tends to manifest itself as command without boundaries and obedience without boundaries. For example, employers often unilaterally set labor discipline rules that are favorable to the employer and tend to ignore the opinions of workers when formulating corporate rules and regulations. In addition, the duties and responsibilities of a worker's position and the

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[30] Jerome Cohen, *Keynote: An Introduction to Law in China*, 8 VT. J. OF ENV'T L., 393, 402 (2007).

[31] *See* ALLEN KRAAKMAN, COMMENTARIES AND CASES ON THE LAW OF BUSINESS ORGANIZATION. 164 (5th ed. 2016).

[32] *See id.*

professional ethics that should be observed are either very vaguely defined, leaving a lot of room for interpretation by the employer, or they are strictly defined, but intentionally disregarded in favor of a completely different set of expectations made by the employer through verbal or other covert means according to employer's interests. When a worker does not comply with the unwritten rules, he can be dismissed for violating the generally ignored written rules or for violating professional ethics, and when he does comply with the unwritten rules, he can be rewarded with a promotion or other benefit. In this way, the dismissal of workers is completely in the hands of the employer through arbitrary manipulation, and the law can easily be reduced to a tool used by the employer.

Another labor dispute related to the command-and-obedience model is also of concern: the issue of overtime. In some industries, overtime work is often mandatory: if they refuse to do overtime work, they can be fined.[33] In recent years, the 996 working hour system, meaning employees work from 9 a.m. to 9 p.m., six days a week, has also become popular among Chinese Internet companies.[34] When faced with mandatory overtime regulations (often unwritten), these employees must either comply or be terminated.

At the same time, Chinese workers are more likely to believe that they are not being discriminated against in situations involving employment discrimination such as race, gender, and disability and accept it as how the society works. In addition, they rarely coalesce into a group, and most of their interactions with employers are carried out as individuals.[35] Thus, the workers' hands are tied in individual labor relationships. Once they leave their respective networks, unless they seek other networks, they seem more comfortable accepting the role of the weak than trying to change it.

In summary, there are deeply-rooted cultural reasons behind the relationship between workers and employers in China. Under such circumstances, they will become vulnerable in the hands of their employers if the law does not provide them with more protection. Therefore, Chinese labor contract law provides a very strict system of employment termination protection and tries to urge employers to enter into indefinite-term employment contracts to prevent the abuse of power by employers and to motivate them to maintain as positive a labor relationship with their workers as possible. On the other hand, since the population does not have a strong concept of discrimination, the mandatory provisions against employment discrimination

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[33] Shen Jie, *The characteristics and historical development of labour disputes in China,* 14, No. 2, J. of Mgmt. History 14.2: 161, 167 (2008).

[34] *China's 9-9-6 Work Culture: Everything You Need to Know-Infographic,* KUNG FU DATA (Apr. 5, 2022), https://kungfudata.com/insights/996-chinese-work-culture.

[35] *See* YANG HAONAN (杨浩楠), supra note 23, at 66. ("Labor relations in China on the whole are still dominated by individual labor relations, and collective labor relations are rare in China").

are too general and lack operability. Thus, compared to the United States, the Chinese government plays an active paternal role to solve the problems of some disadvantaged groups. Of course, with the development of China's market economy, Chinese people's interpersonal relationships are gradually changing. However, this is a long-term process.

Ⅲ. PROBLEMS AND FEASIBLE SOLUTIONS IN CHINESE LAW

A. Laws Governing Employment Termination

1. China Should Boost the Democratic Participation of Employees in the Corporate Process of Making Rules and Regulations

Drawing on the analysis of the cultural factors, it is clear that in order to eradicate the command-obedience model in the workplace, the Chinese government should try to boost the democratic participation of employees in the corporate process of making rules and regulations so that the rules on dismissal can be fairer and more reasonable.

The current legislation is mainly focused on the Article 8 of China's Labor Law which states that "The laborer shall take part in democratic management or negotiate with the employing units on an equal footing about protection of the legitimate rights and interests of laborers through the assembly of staff and workers or their congress or other forms as provided by law."[36] In the labor law, it can easily be seen that company regulations must be formulated with the democratic participation of employees. However, in practice, this article is not well implemented: employers have no incentive to democratically consult with their employees.

Paragraph 2 of the 1997 Ministry of Labor's departmental regulation "Notice of the Ministry of Labor on the Implementation of the Labor Regulations Filing System for Newly Established Employers" stipulated that employer regulations must be filed with the government's labor department, but the regulation was repealed in 2016.[37] As there is currently no requirement for

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[36] *See* Laodong Fa (劳动法) [Labor Law] (promulgated by the Standing Comm. Nat'l People's Cong., July 5, 1994, effective Jan. 1, 1995, revised Dec. 29, 2018), art. 8 (China) (English translation provided by Nat'l People's Cong., available at http://www.npc.gov.cn/zgrdw/englishnpc/Law/2007-12/12/content_1383754.htm).

[37] *See* Laodongbu Guanyu Dui Xin Kaiban Yongren Danwei Shixing Laodong Guizhang Zhidu Beian Zhidu de Tongzhi (劳动部关于对新开办用人单位实行劳动规章制度备案制度的通知) [Notice of the Ministry of Labor on the Implementation of the Labor Regulations Filing System for Newly Established Employers] promulgated by the Ministry of Labor, Nov. 25, 1997, effective

the employers to file corporate regulations with the labor department, the government cannot efficiently supervise the implementation of the democratic participation.

Judicial interpretation also plays a pivotal role in employment law issues in China. Interpretation of the Supreme People's Court on Several Issues about the Application of Laws for the Trial of Labor Dispute Cases, in effect from 2001 until its repeal at the end of 2020, guided the courts in making decisions while it was in effect. Article 19 of it provides that "If the rules and regulations made by the employer through democratic procedures in accordance with the provisions of Article 4 of the Labor Law do not violate the provisions of national laws, administrative regulations and policies, and have been made public to the workers, they can be used as the basis for the People's Court to hear labor dispute cases."[38] However, in terms of specific case trials, what has been agreed upon by all the Chinese courts is that: First, the enterprise rules and regulations must not violate the provisions of laws and regulations. Second, they must be made public to the workers, or at least be told to the workers involved in the case. However, the rules of adjudication vary from place to place as to whether the rules and regulations themselves are subject to democratic procedures. Courts in Beijing, for example, have made strict requirements for democratic procedures for regulations.[39] Courts in Guangdong Province, Jiangsu Province and Zhejiang Province, on the other hand, review it less strictly.[40]

If the democratic procedures for employees are belittled in labor administration and justice, it is very easy for employers to abuse the employees' participation right and make the democratic procedures for employees a mere formality.

In light of the current situation in China, the author believes that, firstly,

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Nov. 25, 1997, repealed in 2016 , art. 8 (China).

[38] *See* Zuigao Renmin Fayuan Guanyu Shenli Laodong Zhengyi Anjian Shiyong Falv Ruogan Wenti de Jieshi (最高人民法院关于审理劳动争议案件适用法律若干问题的解释) [Interpretation of the Supreme People's Court on Several Issues about the Application of Laws for the Trial of Labor Dispute Cases] (promulgated by Sup. People's Ct., Apr. 16, 2001, effective Apr. 30, 2001, revised Dec. 16, 2008, repealed Dec. 23, 2020), art. 19 (China).

[39] *See* Du Kai Yan (杜开颜), Cong Beijing Diqu Panli Kan Yongren Danwei Guizhang Zhidu Xiaoli de Sifa Rending (从北京地区判例看用人单位规章制度效力的司法认定) [Judicial Determination of the Validity of Employer's Rules and Regulations from Beijing Case Law], GRANDWAY LAW OFFICES (Aug. 31, 2020), https://www.grandwaylaw.com/guofengshijiao/2842.html.

[40] *See* Weijing Minzhu Chengxu de Guizhang Zhidu, Ye Keyi Zuowei Fayuan Shenli Laodong Anjian de Yiju Ma? (未经民主程序的规章制度，也可以作为法院审理劳动案件的依据吗?) [Can Rules and Regulations Without Democratic Procedures Also Be Used As the Basis for Court Hearings in Labor Cases?], Wangjing & GH Law Firm (Dec. 5, 2019, 7:30 PM), https://www.wjngh.cn/jofacolumn/info.aspx?itemid=111&lcid=17.

the labor department should strengthen the legal guidance to enterprises and employees on democratic procedures and give full play to the government's functions. In addition, the government should also inform employees of the solutions they can seek when they encounter problems. For example, the government should tell employees that if the rules and regulations of the unit are not legal, they can report to the labor inspection department according to Article 11 of the Regulations on Labor Security Supervision[41], and the labor inspection department will deal with them. By raising the awareness of democracy among enterprises and employees, and informing employees of the solution to the problem, the mindset of employees accepting a take-it-or-leave-it work policy can be broken. Secondly, we should implement a filing system for corporate rules and regulations and require companies to include democratic procedures in their written rules and regulations. If the company has no incentive to make rules and regulations with democratic procedures, the filing of rules and regulations can help the labor inspection department to effectively monitor and inspect the company's rules and regulations.

2. Chinese Employers Should Be Released from Overly Strict Prohibitions on Employment Termination

When comparing the employment termination laws in China and the United States, it is easy to see that they are at two extremes: the United States applies the employment-at-will doctrine, while China applies the statutory termination doctrine which means an employer can only terminate the employment relationship when statutory situations appear.

On the positive side, there are many specific laws, administrative regulations and local regulations at all levels of government in China to protect the rights and interests of people with disabilities and women. It is clear that under the current Chinese cultural model, the government still plays a very active role in regulating certain aspects of labor relations. However, the strict employment termination laws often make it difficult for Chinese employers to fire workers even when they have a valid reason to do so, which increases the cost of firing workers and is detrimental to economic development. The British liberal philosopher John Locke said in *Two Treatises of Government*, "The end of Law is not to abolish or restrain, but to preserve and enlarge Freedom." Since employment relationships are established in the labor market to meet production goals, the deeper goal of legislative restraint is to protect and realize rights, not to restrain them.[42] Therefore, China's employment protection

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[41] *See* Laodong Baozhang Jiancha Tiaoli (劳动保障监察条例) [Regulations on Labor Security Supervision] （promulgated by the St. Council, Nov. 1, 2004, effective Dec. 1, 2004）art. 11 (China)

[42] *See* DONG BAOHUA (董保华), WOGUO LAODONG GUANXI JIEGU ZHIDU DE ZIZHI YU GUANZHI ZHI BIAN (我国劳动关系解雇制度的自治与管制之辨)[The Discernment of Autonomy

system should have more private law characteristics and less public law characteristics. Employers in China should "untie" themselves from the overly strict employment termination laws in order to facilitate the autonomy of both employers and employees in complying with civil contracts and to facilitate the efficient use of labor. Contrary to what some scholars believe[43], the author does not believe that the rights of Chinese workers and the profits of employers are in any way in conflict. On the contrary, to untie the employer in the dismissal of labor is not the same as to reduce the protection of workers, but to promote the mobility of workers to more suitable positions, so that employers can choose more suitable workers to achieve a win-win situation for both employers and employees.

Considering the current situation, the author believes that China's employment termination laws should be appropriately amended or improved on the basis of the following issues:

(i) The Duration of Definite-Term Employment Contracts Should Be More Binding in Civil Law

Unlike in the United States and many other countries, in China, definite-term employment contracts are the norm, and indefinite employment contracts are the exception. Specifically, when an employment contract is first entered into, whether it is for a definite term or not depends largely on the employer who has more bargaining power. However, for the employer, regardless of whether the employment contract is for a definite term or indefinite term, it must be terminated during the term of the contract in accordance with the statutory conditions of termination. Otherwise, it is terminated in violation of the law and the employer must pay a fixed amount of compensation equal to twice the financial compensation (as discussed above). However, in the event of a definite-term employment contract, when the term ends itself, the employer is only required to pay financial compensation. Thus, by entering into a definite-term employment contract, the employer will have an opportunity to end the employment relationship by paying financial compensation at the end of the contract. In contrast, if the employment contract is for an indefinite period, the employer will need to find a reason for statutory discharge in order to legally terminate the worker. Therefore, to facilitate the termination of the employment relationship, many employers choose to enter into fixed-term employment contracts whenever possible.

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and Regulation in China's Labour Relations Dismissal System], ZHENGZHI YU FALÜ (政治与法律) [Pol. & L.] Vol. 4, 2017, 120.

[43] Jeremy Brecher, Tim Costello, John Feffer, Brendan Smith, *Labor Rights in China*, FOREIGN POLICY IN FOCUS (Dec. 19, 2006), https://fpif.org/labor_rights_in_china/. (Implying that the rights of workers in China and the profits of U.S. corporations are contradictory.)

Unlike in the US and other countries, neither the employer nor the employee is strictly bound by the duration of a definite-term employment contract. On the one hand, the worker can terminate it by giving notice in accordance with Article 37 of the Employment Contract Act, so his right to terminate is not bound by the duration of the employment contract. On the other hand, under the employment law, the employer only has to consider whether the statutory circumstances are met when considering termination, and even if it constitutes an illegal termination, the cost is only a fixed amount of compensation, without the employer having to bear the higher amount of liability for breach of contract that may arise under civil law. Such an institutional arrangement, whereby the signing of a definite-term employment contract simply provides the employer with an opportunity to end the employment relationship through the payment of financial compensation, may give rise to the following problems.

(a) During the duration of a definite-term employment contract, the worker can resign on short notice, often causing difficulties for the employer. When a worker first joins a company, there will be a period of trial and error during which he or she can gradually become competent. During this period, the employer is more or less obliged to teach the worker and to tolerate the worker's failure to do the job up to the required standard. Since the parties have entered into a definite-term employment contract, there is a reasonable expectation that the employment relationship will continue for the duration. However, when an employee resigns suddenly, even with prior notice, the employer is often caught unprepared.[44] Conversely, the employer is required to honor the promise to provide a job for a fixed term. There is a clear disparity between the rights and obligations of the two, which runs counter to the principle of autonomy in civil law. Therefore, at least in the case of shorter fixed-term employment contracts, the worker's right to terminate the contract at will should be removed, so that both the worker and the employer can fulfill their obligations and exercise their rights. Both parties should honor the duration of employment specified in the contract. If the worker fails to perform within the term, he or she should be made liable for breach of contract.

(b) Fixed-term employment contracts make it difficult for the employer to establish a long-lasting, stable, and harmonious relationship with the worker. As workers are not sure whether their employer will renew their employment contract until the fixed-term contract expires, they tend to look for a new employer with better wages and other benefits in advance, thus becoming unmotivated to work and even less loyal to their employer. From the perspective of the old employer, although the original intention of signing a fixed-term employment contract is to increase the opportunity to end the relationship by paying financial compensation, it also means that the employer may lose a good

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[44] Supra note 1, art. 37.

employee and "feed" a group of distracted employees who are looking for work at the same time. In the long run, this is not conducive to fostering loyalty to the company, enhancing the attractiveness of the company to the best employees, or promoting the long-term development of the company.

Since the termination of a fixed-term employment contract is a planned, agreed-upon event, it should have more private law and less public law characteristics. Therefore, China should learn from the common practice of the United States and other countries in relation to fixed-term employment contracts and allow civil law remedies so that a party who has been breached by the other party before the expiry of the contract term can, through contract law, seek damages that are higher than the fixed amount of compensation under labor law, thus making employers more willing to choose to enter into indefinite-term employment contracts, thereby achieving the legislative purpose of the labor contract law.

(ii) The Statutory Discharge Clause Should Give Employers an Appropriate Degree of Relief and Solve the Problem of "Difficult Discharge"

Contrary to the employment-at-will doctrine in the United States, where termination is fairly easy, many Chinese employers find it easy to recruit employees but difficult to terminate them, as they can only legally terminate them if they meet the conditions set out in the law and are required to pay financial compensation in many cases, including termination of the contract. Specifically, the Labor Contract Law makes the conditions for termination too stringent, so that Chinese employers who have not hired a company lawyer and have not specifically studied the law can accidentally terminate the contract in violation of the law if they do not follow the conditions set out in the law exactly. The harsh conditions can be seen in the following areas.

(a) The requirement to terminate an employee only if the employee does not meet the conditions of employment during the probationary period places a significant burden of proof on the company. The probationary period is the initial stage of the employment relationship where the employer and the worker get to know each other, and it gives the employer the opportunity to observe and judge the worker's actual working ability, as it is not sufficient to judge a worker simply by looking at the his CV and setting up an interview or other written test. However, Chinese Labor Contract law provides that during the probationary period, employers are only able to dismiss an employee under limited circumstances such as when the worker does not meet the conditions of employment.[45]

The lack of clarity in the definition of employment conditions in the Labor Contract Law has led to some narrow interpretations in judicial practice: to

[45] Supra note 1, art. 39.

prove that a worker does not meet the employment conditions, the employer needs to prove firstly what the employment conditions are, secondly that the worker clearly knows what the employment conditions are, and thirdly that the worker does not meet the employment conditions in certain respects by providing an evaluation form. Ultimately, the judgment as to whether the worker meets the conditions of employment often becomes a judgment as to whether the employer has a written evaluation form. In this regard, some judges have called for a broad interpretation of the conditions of employment, giving the employer more decision-making power, as during the probationary period, "a preliminary assessment of the candidate's personal conduct, professional demeanor, responsibility, diligence, loyalty to the company, etc. is also required".[46] Admittedly, the legislative purpose of requiring employers to prove that the employee does not meet the conditions of employment during the probationary period is to prevent abuse of the employer's power; however, the competency of the worker is measured in a comprehensive and multifaceted manner, so it is not possible for the employer to specify all hiring criteria in advance. As the purpose of the probationary period is to include factors such as whether or not a good relationship can be established between the parties, the employer should be given more discretion to decide whether or not to retain the worker as long as the employer does not abuse his power.

(b) The statutory requirements for employers to dismiss workers are too stringent. China's Labor Contract Law also has strict substantive and procedural requirements for an employer to dismiss an employee. For example, Article 41 provides that in the case of economic redundancy, the employer is required to explain the situation to the trade union or all employees thirty days in advance, listen to their views and report the proposal for redundancy to the labor administration department before the redundancy can take place. Another example is Article 40(2) of the Labor Contract Law, which stipulates that when a worker is unable to do his job, the employer needs to train him or transfer him to a different position, and if he is still unable to do his job, only then can the employer dismiss him. In this regard, I agree with the analysis of a Chinese scholar: there are generally two situations in which a worker is incompetent: firstly, if the worker has a lazy attitude towards work and has not seriously violated the employer's rules and regulations, then it is not justified to "require the employer to train or transfer such a worker" as a condition for the lawful termination of the employment contract; secondly, if the worker is incompetent due to the employer's technological innovation, then the employer may terminate the employment contract. In the second situation, "requiring the employer to train or transfer such workers" is not conducive to the effective

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[46] *See* GUO WENLONG (郭文龙), LAODONG HETONG SHIYONGQI YANJIU (劳动合同试用期研究) [Study on the probationary period of employment contracts], ZHENGZHI YU FALÜ (政治与法律) [Pol. & L.] Vol. 2, 2002, 86.

allocation of the enterprise's human resources.[47]

In the author's view, the strict rules governing discharge are inextricably linked to the social context of the 2007 labor contract legislation. Prior to the enactment of the Labor Contract Law, many workers in China had been working in state-owned enterprises for a long time, holding an "iron rice bowl." They did not need to learn anything new and could not be dismissed by the state-owned enterprises, which over time led to a sense of slackness and a mentality of privilege. As a result of the implementation of the Labor Contract Law in 2008, strict conditions were imposed on employers to terminate workers, considering that the new labor contract system broke the previous system and would lead to discontent among workers in former state-owned enterprises. However, fifteen years on, now that the employment contract system has been fully implemented, and in a context where both state and private enterprises are more concerned with the effectiveness of their work than with providing their employees with super-stable jobs, the excessively strict conditions of dismissal appear to have fallen behind the times. Therefore, the Labor Contract Law should remove these cumbersome provisions and outline the basic framework of lawful termination in more principled and general terms, so that more legitimate reasons can be included in lawful termination.

B. Laws Governing Employment Discrimination

To improve China's laws against employment discrimination, it is instructive to examine the experience of US laws against employment discrimination – taking the laws against sexual harassment in the workplace as an example.

China's existing discrimination laws are scattered within several laws, which are too general, lacking in operability, and unclear in the allocation of the burden of proof. China's culture makes it difficult for employment discrimination laws to evolve spontaneously on Chinese soil, but in China, a land with thousands of years of continuous ancient civilization, eliminating discrimination through anti-discrimination laws in employment is precisely what the Chinese people desire in their hearts, and what China needs. In particular, the legal ramifications of combating employment discrimination not only revolve around the elimination of discrimination but also around raising the consciousness of the right to equality in all aspects of employment.[48]

Sexual harassment is a kind of employment discrimination and has been a

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[47] Supra note 23，at 69.

[48] *See* XIE ZENGYI (谢增毅), MEIYING LIANGGUO JIUYE QISHI GOUCHENG YAOJIAN BIJIAO(美英两国就业歧视构成要件比较) [A comparison of the elements of employment discrimination in the US and the UK], ZHONGWAI FAXUE (中外法学) [Peking Uni. L. J.] Vol. 20, No. 4, 2008, 613, 627.

hot topic in recent years. Here, I will point out some problems with China's current laws against sexual harassment in the workplace and offers some suggestions.

Sexual harassment in the workplace may have always existed in China, but few women have defended their rights. In a 2017 poll of 255 female journalists conducted in China, 80 percent reported that they had been sexually harassed in the workplace, yet less than 20 percent of another 2,000 urban Chinese women surveyed reported experiencing sexual harassment.[49] Legally, Article 40 of the 2018 Revised Law on the Protection of Women's Rights and Interests states, "Sexual harassment of women is prohibited. An aggrieved woman can file a complaint with her employer and the relevant authorities." In addition, it is worth noting that the inclusion of the topic of sexual harassment in the newly enacted Civil Code of 2021 is a step forward in terms of the development of laws against sexual harassment in the workplace. But it still has some problems. Firstly, the Civil Code explains what sexual harassment is by way of example but does not give a clear and unambiguous definition of sexual harassment. Secondly, the Civil Code does not provide for the consequences if the employer does not fulfill his legal responsibilities. Thirdly, the high standard of proof required by the Chinese courts in civil proceedings makes it very difficult for victims to win their cases.[50] Based on a comparison of the laws against sexual harassment in China and the United States, China can improve in the following aspects.

1. Clarify and Expand the Definition of Sexual Harassment

If, as in China, sexual harassment cases are considered to be tort cases, it is inevitable that the tortious act and the intent will have to be proven, increasing the difficulty of proof for the victim. This is a point where the experience of the United States can be drawn upon to build legal liability on top of liability for breach of contract from the perspective of changing the labor environment. Sexual harassment should be a specific form of discrimination in the workplace that is "grossly pervasive." In the U.S., sexual harassment is considered to be an unreasonable interference with an individual's work performance or the creation of an intimidating, hostile, or offensive work environment. As the working environment is a condition of the employment contract, employers may be held liable if unwelcome harassment of a sexual nature is so severe as to cause a change in the working environment. [51]By defining sexual harassment broadly, a wider range of acts of sexual harassment could be included,

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[49] AARON HALEGUA, U.S.-ASIA LAW INSTITUTE, NEW YORK UNIVERSITY SCHOOL OF LAW, WORKPLACE GENDER-BASED VIOLENCE AND HARASSMENT IN CHINA: HARMONIZING DOMESTIC LAW AND PRACTICE WITH INTERNATIONAL STANDARDS. at 11 (2011).

[50] *See Id.*, at 16.

[51] Meritor Savings Bank v. Vinson, 477U.S.57(1986)

increasing the protection of potential victims.

2. Clarify the Responsibility of the Employer

Article 1010 of the Civil Code stipulates that employers should take measures to reasonably prevent sexual harassment, and should receive, investigate and deal with sexual harassment complaints, but it does not stipulate the legal consequences of employers' inaction. This is because sexual harassment is, after all, committed by the individual who harasses another person, without the knowledge of the employer, who is a virtual legal entity. The extent to which the employer is liable for the sexual harassment of an employee is then an issue.

In U.S. sexual harassment laws, employers are automatically liable if they take tangible employment action as a result, such as a dismissal, denial of promotion or benefits, or inappropriate transfer. If there is no actual employment action, the situation is treated differently. The company is also automatically liable if the specific sexual harasser is of sufficiently high standing within the company and can represent the company. If the sexual harasser is an employee who is authorized to take tangible employment action, the employer has the Faragher/Ellerth affirmative defense: "(a) that the employer exercised reasonable care to prevent and correct promptly any sexually harassing behavior, and (b) that the plaintiff employee unreasonably failed to take advantage of any preventive or corrective opportunities provided by the employer or to avoid harm otherwise."[52]If the sexual harasser is a co-worker, customer, or independent contractor, then the victim needs to prove that the employer knew or should have known about the sexual harassment but failed to take prompt and appropriate action. [53]As can be seen, the three types of sexual harassers are subject to different forms of liability under U.S. law, depending on the closeness of their relationship with the decision-making bodies of the company. This is something China can learn from.

Programs against sexual harassment should also be made a regular part of the workplace by Chinese employers, and should be clarified by the Chinese government through, for example, the formulation of government regulations. For example, it should be mandatory for companies of a certain size or more to include in their rules and regulations internal complaint channels and procedures for addressing sexual harassment, and to identify specific people responsible for this at all levels of the company. In particular, workers should be made aware of their rights when they join the company by watching an awareness film and receiving a certificate. In addition, the Chinese government should also give full play to the function of labor inspection organizations by

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[52] *See* SULLIVAN ZIMMER, CASES AND MATERIALS ON EMPLOYMENT DISCRIMINATION 357 (9th ed. 2017).

[53] Vance v. Ball State University, 570 U.S. 421 (2013).

having them conduct regular inspections or occasional spot checks on companies' program against sexual harassment and implementation. It is also possible to learn from the history of the fight against discrimination in employment in the U.S. and to establish a special government agency responsible for handling sexual harassment and other discrimination cases, playing an active role for the government in terms of pre-emptive mediation between employers and workers.

3. Lower the Burden of Proof in Sexual Harassment Cases

Chinese judges have a long history of setting high standards of formalism in civil cases. There are many underlying reasons for China's lack of judicial independence, such as the administrative management of the courts, the varying quality of judges, and the stereotypical appraisal system for judges. The problem can be particularly acute in sexual harassment cases, which mostly involve unwelcome words and touching. In a vivid example, American scholar Aaron Halegua pointed out that where the victim presents evidence that the harassing message came from the defendant's social media account, the court may also find that the victim cannot prove that the social media account was the personal account of the alleged harasser.[54]

If China is still quite a long way from judicial independence, it will be difficult to solve the problem systematically in the near future. The author, therefore, believes that this problem can be helped by improving the implementation of the existing system of proof. Specifically, Article 67(2) of the Civil Procedure Law (amended in 2021) provides that "the people's court shall investigate and collect evidence that the parties and their litigation agents cannot collect on their own for objective reasons, or that the people's court considers necessary for the trial of the case." Article 94 of the Interpretation of the Supreme People's Court on the Application of the Civil Procedure Law of the People's Republic of China provides that the parties "may apply in writing to the people's court to investigate and collect the evidence before the expiry of the period for adducing evidence." The above two articles indicate that if, in order to meet the high standard of proof required by the court, the parties have objective reasons for not being able to collect evidence on their own, they may apply in writing to the court to do so. If they apply at this stage of the case, the court shall collect it. If a party is unable to collect it on its own for objective

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[54] AARON HALEGUA, U.S.-ASIA LAW INSTITUTE, NEW YORK UNIVERSITY SCHOOL OF LAW, WORKPLACE GENDER-BASED VIOLENCE AND HARASSMENT IN CHINA: HARMONIZING DOMESTIC LAW AND PRACTICE WITH INTERNATIONAL STANDARDS. at 116 (2011) (quoting Qin Yi and Wang Haining Civil Defamation Dispute First Instance Civil Judgment [秦漪与王海宁名誉权纠纷一审民事判决书] (Hubei Province Wuhan City E. Xihu Dist. People's Ct., 2016) (China), available at: http://wenshu.court.gov.cn. Although this case did not explicitly address sexual harassment, it demonstrates a significant obstacle for plaintiffs bringing harassment claims.)

reasons and applies in writing to the People's Court to investigate and collect it, and the People's Court fails to do so, the conditions for a retrial under Article 207 of the Civil Procedure Law are met.[55] To implement this law, the existing trial supervision procedures can be used to urge the court to improve the implementation of the said law. Through the parties' application for retrial, the procuratorate will initiate retrial[56] or the court will initiate retrial on its own[57] to urge the court to improve the procedure that "the court should take the initiative to collect evidence," and in this way, the court will in turn reconsider the issue of standard of proof.

CONCLUSION

China's situation is very different from that of the United States, and although the employment termination laws and employment discrimination laws in the United States cannot be copied in their entirety, there are still lessons to be learned. Considering the cultural reasons behind its job protection policies,

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[55] *See* Minshi Susong Fa (民事诉讼法) [Civil Procedure Law] （promulgated by the Standing Comm. Nat'l People's Cong., Apr. 9, 1991, effective Apr. 9, 1991, revised Dec. 24, 2021）, art. 207 (China) (English translation provided by PKULAW, available at https://www-pkulaw-com.proxy.library.cornell.edu/en_law/3ce82cb92ee006b6bdfb.html). （"Article 207：Where a petition for retrial filed by a party falls under any of the following circumstances, the people's court shall conduct a retrial:……(5) For objective reasons, a party is unable to gather any primary evidence necessary for the trial of a case and applies in writing for the people's court to investigate and gather the evidence, but the people's court has not investigated and gathered the evidence.……"）

[56] *See* supra note 43 (art. 215: "Where the Supreme People's Procuratorate discovers that any effective judgment or ruling of a people's court at any level falls under any of the circumstances set out in Article 200 of this Law or any effective consent judgment thereof causes any damage to the national interest or public interest, or a people's procuratorate at a higher level discovers that any effective judgment or ruling of a people's court at a lower level falls under any of the circumstances set out in Article 200 of this Law or any effective consent judgment thereof causes any damage to the national interest or public interest, the Supreme People's Procuratorate or the people's procuratorate at a higher level shall file an appeal. Where a local people's procuratorate at any level discovers that any effective judgment or ruling of a people's court at the same level falls under any of the circumstances set out in Article 200 of this Law or discovers that any consent judgment thereof causes any damage to the national interest or public interest, the people's procuratorate may offer procuratorial recommendations to the people's court at the same level and file a report with the people's procuratorate at the next higher level; and may also request the people's procuratorate at the next higher level to file an appeal with the people's court at the corresponding level. A people's procuratorate at any level shall have the authority to offer procuratorial recommendations to the people's court at the same level regarding violations of law by judges in trial procedures other than the trial supervision procedure.)

[57] See supra note 43，art 214.

China should boost the democratic participation of employees in the corporate process of making rules and regulations. With regard to its employment termination laws, China should increase the private law and moderate the public law. Specifically, both parties to a fixed-term employment contract should be bound by the duration, while the laws should reduce the strict requirements for legal discharge. In terms of laws against employment discrimination in China, the present degree of public awareness and cultural shift is not sufficient for a comprehensive overhaul. However, in relation to the current issue of sexual harassment in the workplace, the laws should clarify and expand the definition of sexual harassment and clarify the employer's liability, while lowering the burden of proof in sexual harassment cases.

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Arbitration as a form of Negotiation

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ABSTRACT

There is a tendency to view arbitration and negotiation as two completely separate notions. This Article challenges that line of thought in the context of international commercial arbitration. Specifically, this Article argues that arbitration is at its core predicated upon negotiation tactics because a party to an arbitration is essentially negotiating with the opposing party and the arbitral tribunal to obtain the outcome it desires. Consequently, mastering negotiation tactics can help that party gain leverage in the arbitration, thereby maximizing its interest. On that premise, this Article concludes by arguing that practitioners should remain creative and open-minded when devising solutions to their clients' legal problems.

KEYWORDS: Anchoring, Negotiation tactics, Persuasion, Ex parte arbitration, Authority

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I. INTRODUCTION

Depending on the audience, the title of this Article may seem preposterous or be read as an oxymoron. After all, many lawyers dedicate their careers to drawing lines and hair-splitting distinctions. In our profession there are criminal lawyers and civil lawyers, and the latter category is further broken down into transactional lawyers and disputes lawyers. In the context of arbitration,[1] which many deem to require a completely different skillset from litigation, it means there are lawyers who draft arbitration agreements and lawyers who subsequently argue over them. While some lawyers work on both contentious and non-contentious matters, these two types are for the most part largely insulated from one another. To those who focus predominantly on one over the other, the supposition that arbitration is a form of negotiation would sound nonsensical.

Against such a backdrop, this Article does not purport that arbitration—specifically, international commercial arbitration—is literally no more than a subcategory of negotiation, although there may be instances where such an assertion is partially true. Rather, the thesis of this Article is that certain key negotiation tactics also underlie arbitral proceedings. Other observers have noted how negotiation/mediation tactics can be handy in the context of arbitral proceedings with respect to issues such as drafting arbitration agreements and appointing arbitrators, or examined in detail how an ongoing arbitration can affect negotiations between disputing parties.[2] This Article, however, goes one step further by arguing that setting aside formality and nomenclature, the fundamental ideas behind negotiation form a critical part of arbitral proceedings.

In particular, well-established negotiation tactics such as reciprocity, social proof, and authority[3] play an unmistakable role behind the scenes of an

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[1] The term arbitration as used in this Article shall refer to "a dispute resolution method by which the disputants agree to submit their dispute to a third party (the arbitrator or arbitrators) for a decision according to agreed-upon norms and procedures and to carry out that third party's decision." JESWALD W. SALACUSE, THE LAW OF INVESTMENT TREATIES 362 (2010). Meanwhile, "international commercial arbitration" is an arbitration between private parties of different nationalities over a commercial dispute. *See* Francis J. Higgins, et al., *Pitfalls in International Commercial Arbitration*, 35 BUS. LAW. 1035, 1036 (1980). But for convenience, this Article will limit its scope to arbitrations capable of producing an arbitral award enforceable under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards, which is more popularly known as the "New York Convention." *See* SIMON GREENBERG ET AL., INTERNATIONAL COMMERCIAL ARBITRATION: AN ASIA PACIFIC PERSPECTIVE (2011).

[2] Erin Gleason Alvarez, *Negotiation in the Context of Arbitration*, KLUWER ARBITRATION BLOG (Jul. 29, 2019), http://arbitrationblog.kluwerarbitration.com/2019/07/29/negotiation-in-the-context-of-arbitration/; Jill I. Gross, *Bargaining in the (Murky) Shadow of Arbitration*, 24 HARV. L. NEGOT. L. REV. 185 (2019).

[3] Robert B. Cialdini, *The Science of Persuasion: Seven Principles of Persuasion*, INFLUENCE AT WORK, https://www.influenceatwork.com/7-principles-of-persuasion/#unity (last visited Mar. 9, 2023).

arbitration. That is because a party to an arbitration continuously engages in an unseen tug-of-war with its counterparty *and* the arbitral tribunal. Between the claimant and the respondent, whoever better understands and uses negotiation tactics during the arbitral proceedings when dealing with both the counterparty and the arbitral tribunal will thus have a higher likelihood of obtaining a favorable outcome from the arbitration.

II. NEGOTIATION IN PRACTICE

Before delving in further, to unfold the thesis of this Article, it is necessary to first set out some general concepts surrounding negotiation as well as the negotiation tactics that will be discussed below. For one thing, "[n]egotiation is a basic human activity."[4] In short, through negotiation, parties seek to adjust their respective positions so that they can strike a compromise.[5] Negotiation is therefore the process through which parties come to a mutual understanding. While negotiation is frequently observed and perhaps most discussed in respect of business, we in fact negotiate with others in non-business circumstances on a daily basis as well.[6] Negotiation is simply an indispensable part of our lives.

Given how ubiquitous it is, many have conducted research and provided their ideas on the skills/tactics behind the art of negotiation. Dr. Robert B. Cialdini's "Principles of Persuasion" especially stand out because they have withstood the test of time, perhaps due to their remarkable simplicity.[7] Among those principles, this Article focuses on reciprocity, social proof, and authority. A brief explanation of how those principles work as negotiation tactics in a business setting is in order.

"Reciprocity" means negotiating parties engage in a game of give and take. Where one party has openly made a concession, the other party is likely to reciprocate by making a concession of its own.[8] By giving up (or pretending to give up) some of their ground, the parties typically meet each other at the halfway point. As for "social proof," it refers to the notion that negotiating parties substantiate their respective positions based on generally accepted

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[4] Perez N. Ghauri, *Introduction*, *in* INTERNATIONAL BUSINESS NEGOTIATIONS 97, 3 (Perez N. Ghauri & Jean-Claude Usunier ed., 2003).

[5] *Id.* (defining negotiation as "a voluntary process of give and take where both parties modify their offers and expectations in order to come closer to each other.").

[6] *Id.* ("It is a process we undertake in everyday activities to manage our relationships, such as between a husband and wife, children and parents, employers and employees, buyers and sellers and business associates.").

[7] *See* Robert B. Cialdini, *Harnessing the Science of Persuasion*, 79(9) HARV. BUS. REV. 72, 79 (2001).

[8] ROBERT B. CIALDINI, INFLUENCE: THE PSYCHOLOGY OF PERSUASION 13 (2007) ("The rule says that we should try to repay, in kind, what another person has provided us.").

practices.[9] One example in transnational transactions would be the tendency to rely on what is market practice in setting the scope of the parties' agreement. The last principle, "authority," means parties tend to obey the demands of perceived authority figures.[10] The implication is that if one party participating in a negotiation can successfully impose its authority upon the counterparty, the likelihood of that party achieving its objective will increase.

At this juncture, the reader might think these negotiation tactics, along with the rest of Dr. Cialdini's "Principles of Persuasion," are self-evident and rooted in common sense. That, however, is because they have already spread throughout the globe in the realm of business negotiations. The volume of international trade today is approximately 45 times what it was in 1950.[11] With this dramatic rise of cross-border businesses in recent decades, negotiation tactics such as those addressed above have permeated national borders and various aspects of life.[12] Moreover, notwithstanding the specific terminology used, the ideas behind Dr. Cialdini's principles are universal. While this Article chose to use them for convenience, ideas offered by others would work equally well.

Based on the authors' collective experience, parties partaking in international and cross-border transactions indeed utilize similar negotiation strategies regardless of their cultural or geographical origins. In conjunction with the proliferation of transnational transactions, the number of international disputes has also soared, with arbitration now being the most preferred choice for resolving international disputes.[13] And as illustrated below, each of the three abovementioned negotiation tactics plays a critical role in arbitral proceedings.

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[9] *Id.* at 88 (referring to "the tendency to see an action as more appropriate when others are doing it").

[10] *Id.* at 163 ("Information from a recognized authority can provide us a valuable shortcut for deciding how to act in a situation.").

[11] *Evolution of trade under the WTO: handy statistics*, WORLD TRADE ORGANIZATION, *available at* https://www.wto.org/english/res_e/statis_e/trade_evolution_e/evolution_trade_wto_e.htm (last visited Jun. 10, 2023).

[12] *See* Jean-Claude Usunier, *Cultural Aspects of International Business Negotiation*, *in* INTERNATIONAL BUSINESS NEGOTIATIONS 97, 126-7 (Perez N. Ghauri & Jean-Claude Usunier ed., 2003) (explaining that while there are some differences in their tendencies, negotiation tactics largely remain the same across cultural lines).

[13] MARGARET L. MOSES, THE PRINCIPLES AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 219 (2008) (describing international arbitration as the "preferred method of resolving disputes."). In one survey, 90% of the participants chose international arbitration as their preferred dispute resolution method for cross-border disputes. *Current choices and future adaptations*, WHITE & CASE (May 6, 2021), https://www.whitecase.com/insight-our-thinking/current-choices-and-future-adaptations.

III. NEGOTIATING WITH THE OPPOSING PARTY

The popular notion is that legal proceedings such as arbitration (and litigation) officially begin only once negotiations between parties have broken down.[14] It follows that arbitration and negotiation therefore must be mutually exclusive concepts. Per this narrative, negotiations start at pre-contract stages and temporarily conclude upon the execution of the contract. Then, if the performance of the contract does not go as planned, negotiations between the parties reemerge as they try to figure out how to resolve their differences. Finally, when the parties' disagreement has come to a dead end, their negotiations are terminated and arbitral proceedings formally begin.

This narrative is inaccurate. The initiation of arbitral proceedings does not prevent negotiations from resuming at a later stage. The fact that an arbitration has been filed hardly marks an irrevocable end to any possibility of further negotiations between the parties regarding their dispute. On the contrary, the parties should be encouraged to return to the negotiation table.[15] It is true that the moment the risks and costs associated with continuing the arbitration outweigh its benefits for one or both sides, the odds of the parties settling increase dramatically.[16]

As a matter of fact, once the parties have agreed to settle their dispute, they may bring the terms of their settlement to life in the form of a consent award rendered by the arbitral tribunal.[17] In this situation, the resulting consent award would be akin to a settlement agreement, which would mean the arbitral tribunal would effectively incorporate the terms of the parties' settlement into the arbitral award.[18] That way, the contract that had given rise to their dispute in the first place would finally be left in the past, while leading to the birth of another (i.e., the settlement agreement). And negotiations, albeit outside of the

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[14] *See* NIGEL BLACKABY ET AL., REDFERN AND HUNTER ON INTERNATIONAL ARBITRATION 28 (6th ed. 2015). Arbitration is more formal and adversarial than negotiation because it resolves disputes "in accordance with neutral, adjudicative procedures affording the parties an opportunity to be heard." GARY B. BORN, INTERNATIONAL ARBITRATION: LAW AND PRACTICE 32 (3rd ed. 2021).

[15] Alvarez, *supra* note 2.

[16] Economically, it makes more sense for a party to settle than insist on arbitrating a dispute if the risks and costs of the latter option outweigh its benefits. There is nothing stopping the parties from reaching a settlement even after an arbitral award has been rendered. *Cf.* BLACKABY, *supra* note 14, at 606 (stating that "the losing party may use the award as a basis for negotiating a settlement.").

[17] ICC Rules of Arbitration, art. 33 (2021). A consent award may be more effective than a settlement agreement entered into outside of the arbitration because it can be enforced under the New York Convention in case one party changes its mind.

[18] This makes sense because the legal relationship of the parties to an arbitration agreement must concern a subject matter that is "capable of settlement by arbitration." U.N. Convention on the Recognition and Enforcement of Foreign Arbitral Awards art. II(1), June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 [hereinafter "New York Convention"].

arbitral proceedings, would have directly helped the arbitration to reach a mutually acceptable outcome.

Arbitral proceedings therefore take place in parallel with the parties' negotiations. But more importantly, critical events which transpire during arbitral proceedings themselves affect the negotiations, regardless of whether dormant or active, between the parties. Even when arbitral proceedings are underway, disputing parties continue to examine each other's relative strengths and weaknesses in connection with the arbitration. In response to their respective evaluations, the parties' bargaining positions also shift throughout the arbitral proceedings.

If one side perceives that the opposing party has a significantly stronger case, provided that no external factors are in play, that party will capitulate by seeking to settle since it would have more to lose if the arbitration were to continue. Each party thereby continuously updates its figurative "reservation price,"[19] which in this context refers to the absolute baseline it would be willing to accept. Ideally, each party should also attempt to ascertain the opposing party's reservation price in an effort to gain leverage. In this manner, unless the arbitral proceedings are officially suspended to give way to negotiations, the parties' tug of war goes on in both the arbitral proceedings and the negotiation.

Additionally, in the same way that negotiating parties justify their positions regarding business terms and conditions during pre-contract stages based on industry practice and market terms, parties to an arbitration cite legal authorities and bring in expert witnesses as well. Arbitrating parties therefore turn to social proof which, once again, is the principle that "one means we use to determine what is correct is to find out what others think is correct,"[20] to prove that its position should prevail. In this way, negotiation tactics remain active behind the scenes of ongoing arbitral proceedings.

IV. NEGOTIATING WITH THE ARBITRAL TRIBUNAL

More significantly, negotiation can serve as an analogy for the fundamental relationship between parties to an arbitration and the arbitral tribunal. The key is to perceive the rendering of the arbitral award as the closing of a transaction. The arbitral award, in that sense, is the executed final version

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[19] *See* R. Venkatesh & Vijay Mahajan, *The design and pricing of bundles: a review of normative guidelines and practical approaches*, *in* HANDBOOK OF PRICING RESEARCH IN MARKETING 232, 235 (Vithala Rao ed., 2009) (defining reservation price as "the maximum price the customer is willing to pay for one unit of a given product"); *What is Reservation Price?*, PROGRAM ON NEGOTIATION AT HARVARD LAW SCHOOL, https://www.pon.harvard.edu/tag/reservation-price/ (last visited Mar. 9, 2023).

[20] CIALDINI, *supra* note 8, at 88.

of the agreement, which means that by arbitrating, a party to an arbitration is in effect negotiating the terms of the agreement with the arbitrator. The party conveys what it wants (i.e., request for relief), substantiates its position using facts and authorities (i.e., legal submissions), and meets with the arbitrator to directly negotiate (i.e., evidentiary hearings). After taking all of that into account, the arbitrator decides whether or not to accept the party's demands, and puts the final outcome into writing that is the arbitral award.[21]

As for that party's opponent in this situation, it would be akin to a third party, or external factors that nevertheless affect the ongoing negotiations.[22] Alternatively, one may conceptualize an arbitration as a multiparty negotiation in which the parties and the arbitral tribunal are each a participant. In this analogy, the opposing party's position acts as external factors or an extra actor, either a third party or another participant at the negotiation table, whose conduct and stance improve or hurt a party's bargaining position against the arbitral tribunal.

Much like external factors such as market conditions, the opposing party's position fluctuates during the negotiation period. The stronger the opposing party's facts and legal arguments are, the weaker a party's leverage against the arbitral tribunal becomes since the "deal" the arbitral tribunal would agree to gets correspondingly worse. To persuade the arbitral tribunal, much like how it would negotiate with the counterparty in a transaction or an arbitration, that same party must also rely on social proof like legal authorities and third-party experts to justify its position.

In addition, the negotiation tactics of reciprocity and "anchoring" play a crucial role. In a business negotiation, parties seek to set an "anchoring point" by aiming for objectives much higher than what they would be happy to accept in a given situation.[23] Starting at the anchoring point, negotiating parties typically split the difference and meet each other at the midpoint.[24] Each party makes concessions and invites the counterparty to make concessions of its own. The concession does not even have to be genuine as long as *the other party*

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[21] The relationship between parties to an arbitration and the arbitral tribunal can be considered transactional because arbitrators are paid by the parties in return for resolving their dispute. *See* BLACKABY, *supra* note 14, at 36 (stating that "the fees and expenses of the arbitrators (unlike the salary of a judge) must be paid by the parties—and in international arbitrations of any significance, these charges are substantial.").

[22] *See* Ghauri, *supra* note 4, at 6 ("Most international business negotiations involve third parties, i.e. parties other than the buyer and seller, such as governments, agents, consultants and subcontractors. These parties may influence the negotiation process as they have different objectives.").

[23] GUHAN SUBRAMANIAN, DEALMAKING: THE NEW STRATEGY OF NEGOTIAUCTIONS 16-9 (2010); *The Anchoring Effect and How it Can Impact Your Negotiation*, PROGRAM ON NEGOTIATION AT HARVARD LAW SCHOOL (Nov. 26, 2019), https://www.pon.harvard.edu/daily/negotiation-skills-daily/the-drawbacks-of-goals/?amp.

[24] CIALDINI, *supra* note 8, at 20-1.

believes it is. This method has been proven to be successful[25] and is accordingly standard business practice, as parties rarely accept their counterparties' initial offer.

Claimants and respondents typically engage in comparable behavior during arbitral proceedings. They frequently request arbitrators to grant them more than what they would be satisfied with (i.e., what they would accept in a settlement), knowing the "anchoring effect" may influence the arbitral tribunal to at least grant their reservation prices (i.e., the less ambitious request for relief).[26] Where arbitrators agree and grant that party's reservation price as a result, the parties have effectively negotiated with and reached a compromise with the arbitrators.[27]

To elaborate on this classic example that the authors often encounter, imagine the following: a party makes two separate requests for relief with one being somewhat optimistic but unlikely to be granted, while the other is closer to the bare minimum it believes it is entitled to but easier to justify. Once set, the anchoring point (i.e., the optimistic request in this example) helps that party achieve its objective via the principle of reciprocity, which to reiterate is centered on the notion that we, as human beings, are psychologically inclined to feel "an obligation to make a concession to someone who has made a concession to us."[28] In turning down that party's optimistic request for relief, a tribunal becomes more likely to grant its reservation price since the less ambitious request would be deemed a concession from the optimistic request.[29] That this practice of "aiming high" is frequently observed in international arbitration indicates that lawyers and arbitrators are—perhaps subconsciously—engaging in negotiation.

It should be also pointed out that the negotiation continues even after the arbitral award has been rendered. This is possible because parties are typically

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[25] *Id.* at 29-30 (noting that the reciprocity rule seems to work in tests and in real life situations, and should be effective as long as the first request is not perceived as "wholly unrealistic").

[26] *See* Mohamed Sweify, *Against Disclosure*, 31 S. CAL. INTERDISC. L.J. 509, 524 (2022) ("It can also be argued that the relief requested by parties may also anchor arbitrators' decision-making.").

[27] *See* Raymond Saner, *Strategies and Tactics in International Business Negotiations*, INTERNATIONAL BUSINESS NEGOTIATIONS 51, 54 (Perez N. Ghauri & Jean-Claude Usunier ed., 2003) ("A compromise is possible when each party meets the other half way. Something is demanded, but it is not absolute. Some cooperation occurs, but not the whole way.").

[28] CIALDINI, *supra* note 8, at 27.

[29] *See id.* at 28-9 ("Suppose you want me to agree to a certain request. One way to increase your chances would be first to make a larger request of me, one that I will most likely turn down. Then, after I have refused, you would make the smaller request that you were really interested in all along. Provided that you have structured your requests skillfully, I should view your second request as a concession to me and should feel inclined to respond with a concession of my own, the only one I would have immediately open to me—compliance with your second request.").

permitted to request the arbitral tribunal to make corrections to or provide an interpretation of the already-rendered award.[30] With the arbitral award already materialized, their leverage over the arbitral tribunal is, admittedly, quite limited. But there is still some room for negotiation no matter how negligible it may seem, and that is what truly matters. There is still a chance for parties to improve the situation they are in through negotiation.

V. NEGOTIATIONS IN EX PARTE ARBITRATIONS

This Article's "arbitration as a form of negotiation" analogy is most vividly illustrated in ex parte arbitrations, which are arbitrations where one side does not participate. Ex parte arbitrations are more prevalent than one might assume in international commercial arbitration,[31] as parties often refuse to participate because they intend to contest enforcement or due to some other cause.[32] A party may refuse to participate in the arbitration from the outset, or initially participate only to abruptly disappear.[33] From their perspective, such non-participation may even be perfectly rational.[34] That would especially be the case if the non-participating party believes its merits on the case are tenuous, but its odds of evading or resisting enforcement are strong.

Where that happens, the abovementioned negotiation principles of social proof and anchoring/reciprocity likewise apply to the underlying relationship between the sole participating party and the arbitral tribunal. Take anchoring, for instance. The sole participating party's request for relief is likely to have an anchoring effect on the arbitral tribunal's findings, especially without another party dropping an anchor on the opposite end. It would be imperative, therefore, for the sole participating party in an ex parte arbitration to set an effective anchor against the arbitral tribunal.

At first glance, one may assume the sole participating party in an ex parte arbitration would have higher odds of prevailing than in a regular, adversarial

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[30] UNCITRAL Model Law on International Commercial Arbitration art 33(1) (2006); ICC Rules of Arbitration art 36 (2021); Joongjaebeob [Arbitration Act] art. 34 (S. Kor.).

[31] Non-participation is normally attributable to respondents, although in rare circumstances claimants may cease participating in the arbitration as well. Claudia T. Salomon & Florian Loibl, *Respondents' Non-Participation in International Arbitration: A Practical Analysis for Claimants and Tribunals*, 30 AM. REV. INT'L ARB. 441, 441 (2019).

[32] Russell Thirgood & Erika Williams, *The Non-Responsive Respondent: Taking an Arbitration Forward and How*, 85 INT'L. J. ARB. MED. & DISP. MGMT. 65, 65 (2019); BLACKABY, *supra* note 14, at 410 (finding that "it is likely that a party who boycotts an international arbitration intends to resist enforcement of any award ultimately rendered.").

[33] Salomon & Loibl, *supra* note 31, at 441.

[34] *See* W. M. Reisman, *The Enforcement of International Judgments*, 63 AM. J. INT'L L. 1, 23 (1969) ("In bilateral disputes, non-involvement is often the most expedient and economical course of action.").

arbitration. The rationale is that the sole participating party would only have to directly convince the arbitral tribunal of the merits of its case. Going by this Article's analogy, that party would just have to negotiate the terms of the pending arbitral award with the arbitral tribunal without having to account for any external factors. Since there would be no adversary providing the arbitral tribunal with unfavorable facts and legal authorities that hurt its leverage, common sense dictates that the sole participating party's advantage would be insurmountable.

In reality, however, that may not necessarily be true. Unlike judges, arbitrators cannot grant default judgments.[35] Nor do they grant one side's unilateral requests in an ex parte arbitration just because the other party is not participating.[36] In contrast, as a creature of consent, an arbitration must satisfy the applicable legal system's minimum due process standards.[37] Otherwise, the validity and/or enforceability of the arbitral award may be at risk.[38] For one thing, this means the sole participating party must still meet its burden of proof in respect of the arbitral tribunal, which will decide the case based on the facts and legal rules put forth in front of it instead of rendering a default judgment.[39] In short, "even if a party fails to present its case, the arbitral tribunal must consider the merits and make a determination of the substance of the dispute."[40] At the same time, arbitrators must continue to give the non-participating party a full opportunity to begin participating again at any point during the arbitral proceedings.[41]

Throughout this process, arbitrators strive to ensure due process of the proceedings and the enforceability of the award. Arbitrators are not there to merely confirm the sole participating party's legal or factual claims.[42] They are instead expected to carefully question that party's position.[43] Feeling the need

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[35] BLACKABY, *supra* note 14, at 410 ("Unlike a court, an arbitral tribunal has no authority to issue an award akin to a default judgment.").

[36] BORN, *supra* note 14, at 235 (noting that "the tribunal is responsible for assessing the issues presented to it; a party's non-participation does not abrogate that obligation."); MOSES, *supra* note 13, at 163-4; Thirgood & Williams, *supra* note 32, at 65.

[37] Courts will review and refuse enforcement of an arbitral award which fails to meet such due process standards. BLACKABY, *supra* note 14, at 59; MOSES, *supra* note 13, at 18, 84; Thirgood & Williams, *supra* note 32 at 76.

[38] *See* Salomon & Loibl, *supra* note 31, at 462. Additionally, under the New York Convention, courts may refuse enforcement of a foreign arbitral award if either party was not given a full opportunity to present its case. New York Convention, art. V(1)(b). Thus, non-participating parties must be given a chance to resume participating if they so wish.

[39] BLACKABY, *supra* note 14, at 411.

[40] *Id.* at 410.

[41] MOSES, *supra* note 13, at 164; UNCITRAL Model Law on International Commercial Arbitration art 25(b)-(c) (2006); ICC Rules of Arbitration art 5(2) (2021); Joongjaebeob [Arbitration Act] art. 26(2)-(3) (S. Kor.).

[42] *See* Salomon & Loibl, *supra* note 31, at 456.

[43] *See id* at 457.

to appear as impartial as possible, they may even go overboard in terms of speaking up for the non-participating party as a consequence.[44] That would especially be the case where the arbitrators are far more perceptive and capable than the non-participating party and its legal counsel would have been. Where an arbitral tribunal seemingly goes too far or imposes an excessively high burden of proof, the sole participating party should certainly point that out.

But there is a "deep-seated sense of duty to authority within us all."[45] As such, the participating party may be wary of asserting its case too strongly or challenging the arbitral tribunal's views even if not speaking up would hurt its interest. To provide one example, there could be instances where a party cannot compellingly plead its case unless the arbitral tribunal draws an adverse inference[46] due to the opposing party's non-participation. In this scenario, that party would be unable to obtain what it needs without directly requesting the arbitral tribunal to draw an adverse inference.[47] Even then, fear of being rejected by or simply annoying the arbitral tribunal might discourage that party from making such a request.

In that manner, the perceived authority of the arbitrators may tilt the negotiations between the arbitral tribunal and the party in the former's favor.[48] This factor is perhaps most impactful in arbitrations involving East Asian practitioners. For example, research has found that in a business setting Chinese employees are most responsive to the principle of authority whereas American employees most strongly adhere to reciprocity.[49] As for their personal experience, the authors have witnessed legal counsel based in another East Asian country use awkward and unnecessary expressions such as "we humbly accept" in response to the arbitral tribunal's rather trivial instructions.

In the authors' view, parties to an arbitration must realize that blindly deferring to the arbitral tribunal's authority may weaken their cases. Instead, it is by using negotiation tactics such as social proof and anchoring/reciprocity that parties can increase their chances of obtaining a favorable "deal" (i.e., a

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[44] *See* MOSES, *supra* note 13, at 183 (finding that an ex parte arbitral proceeding may impose "a heavier burden on the tribunal"); *see* Thirgood & Williams, *supra* note 32, at 69-70.

[45] CIALDINI, *supra* note 8, 160.

[46] As reflected in IBA Rules on the Taking of Evidence, the adverse inference rule is a firmly established rule in international arbitration. BLACKABY, *supra* note 14, at 387.

[47] *Cf.* BARBARA A. BUDJAC CORVETTE, CONFLICT MANAGEMENT: A PRACTICAL GUIDE TO DEVELOPING NEGOTIATION STRATEGIES 162 (2007) ("In negotiation, if you are to obtain what you desire, you must communicate your desires.").

[48] CIALDINI, *supra* note 8, at 165 (summarizing that "in many situations where a legitimate authority has spoken, what would otherwise make sense is irrelevant. In these instances, we don't consider the situation as a whole but attend and respond to only one aspect of it.").

[49] Robert B. Cialdini, *The Science of Persuasion*, 284 SCIENTIFIC AMERICAN 76, 81 (2001), *available at* https://digitalwellbeing.org/downloads/CialdiniSciAmerican.pdf. Another study similarly concluded that reciprocity and loyalty, respectively, drive American and Chinese attitudes towards friendship. Usunier, *supra* note 12, at 195.

favorable arbitral award) from the arbitral tribunal. The notion of negotiating with a tribunal may fall outside of a party's comfort zone, but there are situations where that may be precisely what is needed to prevail.[50] The same party should be cognizant of the fact that successful negotiators make cultural adaptations if doing so would help them obtain more favorable results.[51] As put by Professor Reisman, self-interest is a "motive force in international law."[52] For that reason, parties to an arbitration should more eagerly adopt negotiation tactics to maximize their self-interest.

VI. CONCLUSION

In this vein, negotiation tactics form an integral part of the logic behind arbitration. Negotiation, in a sense, *transcends* arbitration. At the end of the day, in both negotiation and arbitration, the objective is to persuade the other side. By mastering basic negotiation tactics and utilizing them depending on the circumstances,[53] lawyers can thus improve the odds of their clients obtaining the best possible outcome, whether that be via arbitration or other means. This observation further suggests that arbitration lawyers could very well learn a thing or two from their transactional peers. As this Article demonstrates, negotiation skills are quite frankly "lawyer skills" as opposed to "transactional lawyer skills." Expertise in negotiation skills can definitely help arbitration lawyers as well.

That returns us to the title of this Article, which should no longer seem ludicrous. While this Article focused only on a select few negotiation tactics, it now seems natural to believe there could be more intersecting points between arbitration and negotiation. The authors would like to explore those should the opportunity arise. Regardless of nomenclature, all lawyers share the same objective in that they strive to solve problems for their clients. Those problems can take various forms and span across multiple fields. Accordingly, optimal solutions to such problems may overlap between two or more legal fields as well. And among other qualities, a lawyer who is creative and open-minded will be in the best position to find those solutions.[54]

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[50] *See* CORVETTE, *supra* note 47, at 148 (arguing that "in situations in which legitimate position power exists and is known, you must guard against letting the apparent imbalance of power diminish your goals and your confidence.").

[51] Usunier, *supra* note 12, at 134-5 (summarizing how negotiators step out of their own cultures to adapt to intercultural negotiation).

[52] Reisman, *supra* note 34, at 23.

[53] *See* Saner, *supra* note 27, at 62 (concluding that "[t]here is no all-embracing answer" to the question of which negotiation tactic should be adopted).

[54] *Cf.* CORVETTE, *supra* note 47, at 7 ("Critical thinking requires an inquisitive mind—asking why and how. It requires openness to options. It requires knowing oneself— one's biases,

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Hong Kong as a Mainland Solar Industry Securitisation Centre: Lessons for Chinese and Global International Financial Centres

*Bryane Michael**

ABSTRACT

Does financial law shape the competitiveness of an international financial centre? Or does technological change and growth attract the people and assets which turn towns in megalopoli? Hong Kong's bid to dominate the Chinese photovoltaic (solar panel) industry illustrates these issues all too clearly. My analysis traces the way laws on asset and debt securitization have left rival financial centres - like Chicago -- to sell interests in China's still relatively stable solar energy markets. The paper shows the size of the market opportunity and points to several factors that have hampered Hong Kong from developing a more tech-friendly financial law.

KEYWORDS: solar energy, cleantech, international financial centre, securitisation

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I. Introduction

Chinese solar industry companies have the potential to "utterly and totally" revolutionize the solar energy business worldwide. At least, many media outlines like Fortune claim. [1] Whether or not China does end up dominating the industry or not – the country's solar industry offers tempting prizes to financial organisations in jurisdictions ready and able to provide finance. As competition between international financial centres heats-up – such competition occurs between jurisdictions themselves as much as between financial services firms. Jurisdictions like New York and London, which can offer a financial law that encourages the finance of innovative industries like the solar panel and photovoltaic electricity provision industries, will generate profits which promote employment, tax revenue and other benefits. Yet, how can up-and-coming jurisdictions (like Hong Kong) compete with London and New York? And what does Hong Kong's experience teach other financial centres looking to compete in the securitisation space?

In this paper, we explore the role that Hong Kong's financial intermediaries can play in intermediating investments in local and Mainland-based solar-based (photovoltaic) energy generation technologies. We show how Hong Kong's financial law can respond to market needs, by following the lead of jurisdictions like the US and UK. In the first section, we review the case of securitising solar assets – for readers unfamiliar with the sector. The second section looks at the historical reasons why Hong Kong's financial regulators have taken such a passive role in adopting the regulations which can encourage the use of Hong Kong law to securitise solar assets on the Chinese Mainland. The third section describes the changes needed in the way information providers offer information about securities of all types. By reducing barriers to the offer of such information, Hong Kong can encourage the solicitation and marketing of such solar-related assets. The fourth section shows what – if Hong Kong adopts the necessary regulations – the eventual regulatory regime governing the offer of Mainland solar securitised assets might look like. The fifth section describes the changes needed for Hong Kong to reach such an eventual regulatory regime. The final section concludes – by pointing to the broader issues relevant for the roughly 84 financial centres competing for global finance business.[2]

We should provide several caveats before we begin. First, we do not claim to provide a complete background of securitisation law or Hong Kong's

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[1] *See* Katie Fehrenbacher, China is utterly and totally dominating solar panels, FORTUNE, Jun. 18, 2015.

[2] To see a list of these top 84 financial centres, and the way they compete for assets under management, *see* Mark Yeandle and Michael Mainelli, GLOBAL FINANCIAL CENTRE INDEX 17, 2015.

financial law. We provide references to readers interested in deeper analysis throughout the paper, as relevant.

Second, we do not discuss the macroprudential aspects of financing solar energy projects on the Mainland. The Hong Kong government and many other scholars focus very heavily on managing financial system risks.[3] We accept that encouraging the benefits of solar asset securitisation will have negative consequences – which we deliberately ignore in order to limit the size of our paper. Third, our references to other countries' laws and practices – particularly those of the US and UK – should not be taken as unquestioning acceptance of their practices. We acknowledge the risks and problems inherent in much of the legislation/regulation we describe. Yet, providing a comprehensive overview of these countries' securitisation-related law would also take our paper hopeless off track. Fourth and finally, we make observations about other financial centres, based on Hong Kong's experience. Every financial centre is unique – and we can only paint our recommendations with broad brush strokes that hide much of the necessary detail. We hope the present study will encourage scholars to fill in those details in subsequent work.

Ⅱ. Why securitise solar assets?

The decrease in global asset securitisation – combined with the potential of solar company asset securitisation – provides ample opportunities for Hong Kong investors.[4] Figure 1 shows the value of asset-backed commercial paper, collateral debt obligations and asset-backed securities worldwide.[5] Until 2009, the value of these securities easily amounted to over $1 trillion. After the crisis, the value of new securitisations has fallen. Such securitisation can only deepen Hong Kong's financial markets. Asset-backed securities and obligations represent an important part of the swap trades which provide short-term liquidity to banks and companies alike. Hong Kong holds roughly $94 billion of US government agency asset-backed securities and about $1 billion of corporate ones.[6]

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[3] For an overview, *see* Dong He, *Hong Kong's Approach to Financial Stability*, 9 INT'L J. OF CENTRAL BANKING 1, 2013.

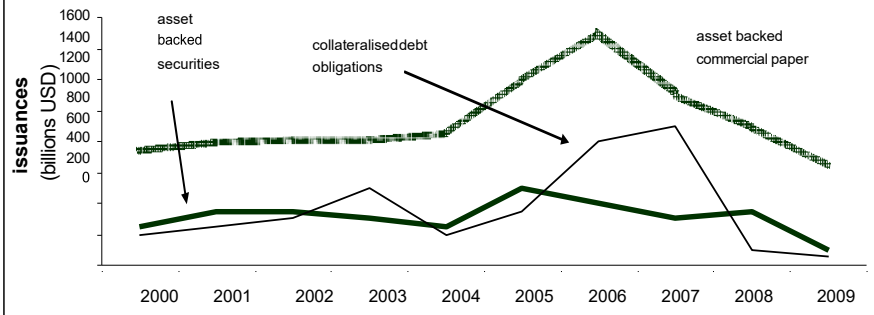
[4] Securitisation, in general, provides many advantages for companies like those in the Mainland's photovoltaic industry.

[5] *See* John Kiff, Andy Jobst, Michael Kisser, and Jodi Scarlata, *Restarting Securitization Markets: Policy Proposals and Pitfalls*, *In* IMF, GLOBAL FINANCIAL STABILITY REPORT: NAVIGATING THE FINANCIAL CHALLENGES AHEAD, 2009.

[6] See Federal Reserve Board, *Value of foreign holdings of U.S. securities, by major investing country and type of security as of June 30*, 2012, at Table 6.

Yet, we "make" very little of these asset-backed securities (outside of the mortgage sector) by ourselves. The total value of these securitized assets weigh in at less than half of their pre-crisis level. If Hong Kong financial institutions can originate and sell these types of securities, they can profitably participate in the recovery of a multi-billion dollar industry.

Figure 1: Global Collapse in Securitisations Represents an Opportunity for Hong Kong



The figure shows the issuance of "private label" securitisation by type. Source: Kiff et al. (2009) at Figure 2.2

Within the asset-based securitisation sector, solar securities probably have the most room to grow. Figure 2 shows the value of solar structured assets, compared with other kinds of structured securities in the US.[7] Auto loan, credit card and student loan securitisations make up the bulk of such securitisations in the US– with potential solar securitisations representing only a fraction of the market total. If solar-backed assets grow to the same level as securitisations on assets like human capital (student loans) or equipment, and if Mainland markets look anything like their US counterparts, the market for solar-backed securities should grow by at least $20 billion. Moreover, the experience from securitising and selling solar-backed securities can help Hong Kong's financial institutions grapple with the complexities of selling proven lucrative assets like auto loans and credit card asset-backed securities (originated on Mainland assets, of course).[8]

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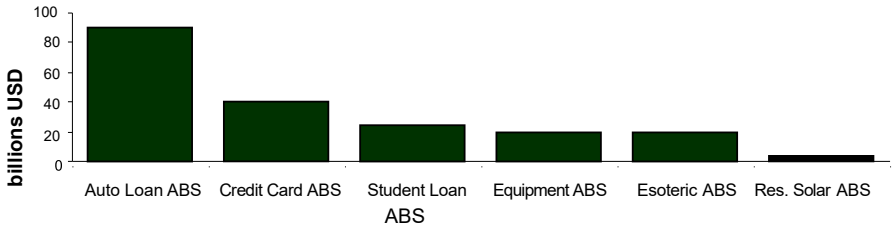
[7] *See* Travis Lowder and Michael Mendelsohn, *The Potential of Securitization in Solar PV Finance, Technical Report*, NREL/TP-6A20-60230, 2013.

[8] Market sizes in Hong Kong are too small to make such securitisation very profitable for Hong Kong situated assets. Thus, the rapid development of Hong Kong's securitisation sector relies on access to Mainland markets (and underlying assets like credit card and auto debt).

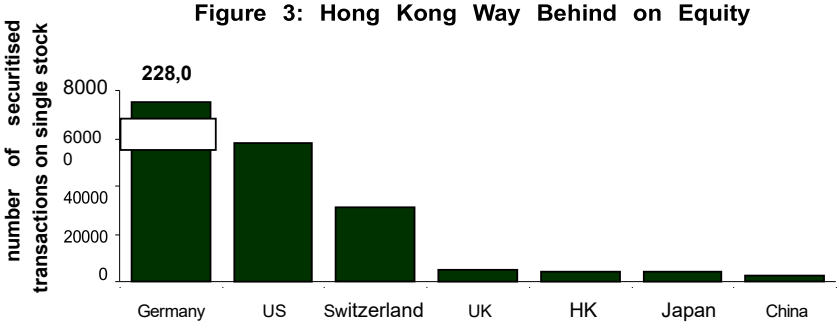
Figure 2: Small Size of US's Solar Asset-Backed Securities Market Represents



The figure shows the estimated size of US asset backed securities markets. The Solar ABS market estimate reflects estimates of potential origination once the market develops.
Source: Low der and Mendelsohn (2013) at Figure 5.

Yet, Hong Kong's financial institutions have a long way to go before they can hope to compete in the creation and sale of asset-backed and debt-backed securities. We know very little about how much of these securities Hong Kong financial institutions actually make.[9] Yet, some data do exist. Figure 3 shows the number of single security asset- backed securities issued in Hong Kong (as a proxy for the importance of Hong Kong's structured securities internationally).[10]

Figure 3: Hong Kong Way Behind on Equity



The figure shows the number of observations of single stock underlying securitized transactions as reported by Datastream between 1995 to 2008.
Source: Bergstresser (2008).

[9] The HKMA provides regular monitoring of debt, derivatives and structured securities. However, they include mortgage-backed securities in their analysis – leaving the analyst unable to figure out the volume of "productive assets" be securitised, structured and sold. *See* HKMA, *Results of surveys on selected debt securities and off-balance sheet exposures to derivatives and securitisations*, 2013.

[10] *See* Daniel Bergstresser, *The retail market for structured notes: Issuance patterns and performance, 1995-2008*, HBS WP, 2008.

As shown, Hong Kong securitisation comes in far below those of other international financial centres on the sale of single-stock derivative contracts. Reassuringly however, China ranks even lower. As such, Hong Kong's financial institutions can compete in the cross-border sale of securities written on Mainland assets and liabilities -- though their competition will likely come from UK and German interlopers rather than native companies.

Despite its large potential, solar securitisations appear unlikely on the Mainland for the foreseeable future. Mainland regulators have made significant progress in putting regulations in place which govern such securitisation – after a significant hiatus in the post-crisis period.[11] Despite Schwartz's plea to open the Golden Sun Demonstration Project's assets for securitisation, such prospects seem remote.[12] A number of issues remain – including institutional support, credibility, and an adequate regulatory structure putting into practice regulations like Administrative Measures on Pilot Projects of Credit Assets Securitisation as well as the Regulatory Measures on Financial Institutions Undertaking Credit Assets Securitization (among others).[13] Even in the US, the recent sale of "sunshine-backed bonds" shows the market has a long way to go.[14] If Hong Kong can tap these markets during the Mainland's adjustment period, securitisation markets will likely stay with Hong Kong.

Securitisation lowers solar companies' costs, making funding through securitisation a preferred method of finance for many types of solar assets and liabilities. Figure 36 shows the levelised cost of solar-generated electricity under a range of financing options.[15] Debt financing – and specifically financing through selling asset-backed obligations – results in cheaper solar finance than traditional finance. Equity, while providing cheaper money, can also actually increase the cost of capital to photovoltaic cell producers (if the US experience applies to the Mainland). These findings suggest that simply listing on the Hong Kong Exchange may not improve Mainland solar companies' competitiveness (by lowering their cost of capital). Hong Kong financial law and government policies needs to find ways of encouraging financial institutions to create and trade debt and debt-based securities in order to provide competitive capital to the Mainland's (and others') solar companies.

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[11] *See* Takeshi Jingu, *Significance of Restart of Asset Securitisation in China*, NRI WP 176, 2013.

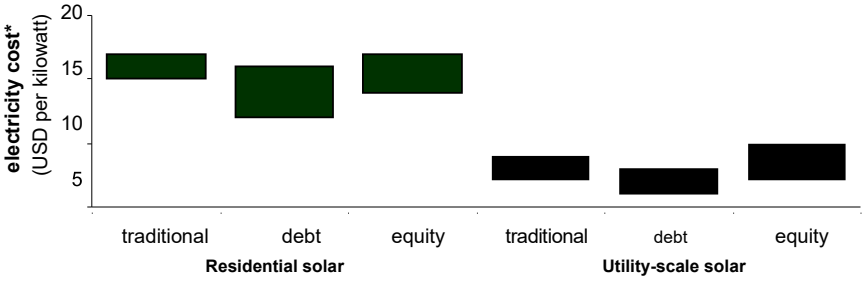
[12] *See* Louis Schwartz, *Securitization of Solar Assets in China*.

[13] For an overview of some of these rules, *see* Yuwa Wei, *Asset-Backed Securitization in China*, 6 RICH. J. GLOBAL L. & BUS.225, 2007.

[14] *See* Tracy Alloway, *Sunshine-backed bond to go on sale*, FT, Nov. 5, 2013. *See also* Diane Cardwell, *Bonds Backed by Solar Power Payments Get Nod*, N.Y. TIMES, Nov. 14, 2013.

[15] Levelised cost of electricity refers to the price which electricity providers need to charge in order to pay their inputs and give investors a market rate of return. For the figure, *see* Michael Mendelsohn and David Feldman, *Financing U.S. Renewable Energy Projects Through Public Capital Vehicles: Qualitative and Quantitative Benefits*, NREL/TP-6A20-58315, 2013.

Figure 4: Equity and Debt Solar Finance Provides for Cheaper Electricity than Traditional Finance



The figure shows the range of levelized costs of electricity under traditional, debt and equity financing in the US. See the original for exact definitions. Source: Mendelsohn and David Feldman (2013) at Figure ES-1.

Many analysts agree that securitisation represents the best form of finance for solar investments. Unlike conventional bank or stock investments, the sale of securitised assets would allow for a larger investor base and better targeting of risk-return profiles.[16] If the US experience serves as any guide, the Mainland solar energy provision and financing markets will likely segment along geographical lines. Figure 5 shows the development of solar finance companies across the US. We focus on finance companies – rather than solar panel or electricity distributors – in order to discuss the consumer financing side of the industry. As shown, some companies (like Sun Edison) and Clean Power Finance offer services nationally. Yet, we see a range of companies which specialise on regions (groups of states) – like Solar City, Skyline Innovations, and Tioga. Others focus only on one state – like BGE Hone and CT Solar Lease. Such differentiation between solar finance providers strongly suggest differences in consumers' preferences and needs across states which one or more national finance providers can not serve (at least not yet). If each of the companies we list in the figure issues stocks, bonds, and asset-backed securities, this would generate 57 different issues.[17]

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[16] For a fuller discussion, *see* Samantha Jacoby, *Solar-Backed Securities: Opportunities, Risks, and the Specter of the Subprime Mortgage Crisis*, 162 U. PA. L. REV. 203, 2014.

[17] Namely, we assume that Amberjack Solar would have its own traded shares, bonds and asset-backed securities (3 different issues), BGE Home similarly (for 3 more) and so forth. Naturally, if these companies issue preferred shares, different types of debt instruments and different types of asset-backed securities, the number of issues can easily exceed 100 types of instruments that investors can buy to gain exposure to the risks and returns in the solar finance sector.

Figure 5: Niche Solar Finance Companies Provide Access to Geographically Specific Risks as well as Differing Risk/Return Profiles

Solar Financing Company	Available in:	Solar Financing Company	Available in:
Amberjack Solar	MA, NJ	**Solar City**	CA, MA, MD, WA
BGE Home	MD	**Soltage**	CT, MA, NJ
Bright Grid Solar	AZ, CA,CO, HI, NJ	**Skyline Innovations**	AZ, CA, FL, Mid-Atlantic States
Citizenre	AR, CT, DE, GA, HI, LA, MA, MD, ME, MN, NH, NJ, NY, OK, OR, RI, VA, VT, WA, WY	**Sun Edison**	Nationwide
CentroSolar	AZ, CA, NJ	**Sun Power**	AZ, CA, CO, HI, MA, NJ, NY, PA
Clean Power Finance	Nationwide	**Sun Run**	AZ, CA, CO, HI, MA, NY, OR, PA
Constellation Energy/ BGE Home	MD	**Sungevity**	AZ, CA, CO, DE, MA, NY, NJ, MD
CT Solar Lease	CT	**Technology Credit Corporation**	MA
First Light Solar (FLS Energy)	NC, SC, GA and TN	**Tioga**	AZ, CA, CO, CT, HI, MA, MD, NJ, NV, OR, OR, PA
Mercury Solar – Financing	CT, MA, NJ, NY, PA	**Vivint Solar**	NY, HI, UT
GroSolar	PA		

Note: Solar production in 2012 reached the following levels: California (983Mw), Arizona (709Mw), New Jersey (391 Mw), Nevada (226), Massachusetts (123), North Carolina (122Mw), Hawaii (114), Colorado (103), Maryland (80), New York (56), others (434). Total equals 3341 Mw.
Sources: Horton (2013) and Jacoby 2013 at Fig. 2.

The geographical spread of solar finance companies in the US suggests three things for Hong Kong as it develops its solar securities markets. First, Hong Kong's financial institution can create literally hundreds of different

securities from the likely range of solar R&D, producer, operations, finance, and other parts of the value chain. In the US example, we asserted that ambitious securitizers could produce 57 different issues of solar finance-based securities. For Hong Kong-based financial firms looking to do the same for Mainland-based producers and financiers, we could expect similar numbers.[18]

Second, providing securities based on the securitised assets and liabilities of these kinds of solar financing firms could provide Hong Kong, Mainland, and international investors with focus on particular geographical markets they want to take solar risks and returns in, while offering diversification. Third, we could even see securities aggregators issuing mixtures of these securities in different combinations as pre-packaged products. Let's continue with our example as illustrated above. If investors wanted exposure only to Pennsylvania, Massachusetts, and Maryland, they could buy a pre-packaged fund with securities only from GroSolar, Technology Credit Corp., and BGE Home. Diversity in the underlying tastes and technologies of solar financing alone suggest Hong Kong-based financial institutions could offer literally hundreds of different securitised products.[19]

A financial centre also provides the analytical tools which can help keep Mainland photovoltaic companies' cost of capital low. Solar project costs of capital usually rise if finance clients (the households and companies using the solar panels) default on their loans/leases and if the company must keep excess capital to cover obligations implicit in its asset-backed securities.[20] Having some Hong Kong financial firms which focus on solar investments can help ensure solar-backed risks are correctly priced -- thus lowering Mainland solar companies' cost of capital. Figure 6 shows the wedge between the rate that investors want and the rate that photovoltaic manufacturers must pay for capital.[21] These wedges increase as default rates among solar panel users

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[18] China has fewer provinces than the US has states. However, the diversity between Chinese provinces (and thus differences in tastes and technologies) greatly exceeds that of the US in general (though of course US states have large differences in types of consumers within states and even buildings!).

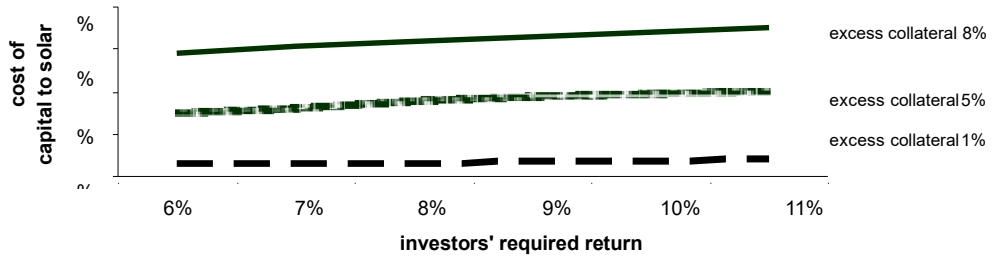
[19] We exclude in our discussion "covered bonds" – which provide guarantees of repayment in case of default or non-payment in the underlying assets. Some analysts have suggested that Chinese securities laws make recovery easier for covered bonds than securitised assets. As our paper is already complex enough, we do not want to explore this issue further. *See* Robert Freedman & Patricia Hammes, *US Solar: Of PPA Securitisations, horizons & hurdles,* INFRASTRUCTURE J., 2011.

[20] A wide variety of factors determine the cost of capital. We talk about those factors that policy can affect. *See* Geoffrey Klise, Jamie Johnson, and Sandra Adomatis, *Valuation of Solar Photovoltaic Systems Using a Discounted Cash Flow Approach*, APPRAISAL J., 2013.

[21] For a calculation of the range of values, *see* Alafita and J.M. Pearce, *Securitization of residential solar photovoltaic assets: Costs, risks and uncertainty*, ENERGY POLICY, 2014.

(borrowers) increase and as companies need to increase the value of panels they bundle into securities.[22] If companies or financiers miscalculate these values, costs of capital can rise (as financiers over-provision capital or over-estimate investors' required returns).

Figure 6: Excess Capital Costs Paid on Solar Projects Due to Early Contract Termination and Excess Collateral Requirements



The figure shows the cost of capital to photovoltaic producers for a 5% early contract termination rate and the effect of over-collateralisation. Solar projects need to over-collateralise (or pledge the value of solar assets). in excess of the value of the securities) in order to receive a sufficiently high credit rating.

Source: Alafita and Pearce (2014) at Table 2.

Hong Kong provides additional opportunities for securitising solar assets which are unavailable in the US. First, Hong Kong-based (and/or listed) solar financing firms have a stronger implicit guarantee of bailouts in case of financial difficulty. The international media reported extensively on Chaori Solar's default. Yet, at roughly the same time, LDK Solar received loans from China Development Bank (a state-owned and controlled financial institution) after its bond default.[23] While Chaori's default tests the Government's resolve to support solar companies, no one believes the Chinese state has completely removed implicit support for solar companies.[24] Such a guarantee thus should cover Hong Kong investors putting their money in these companies. Second,

[22] Asset-backed securities possess solar panels as underlying assets. The prices of these panels may vary depending on age, supply and demand, and other factors. An asset-backed security traded for $1,000 which allows investors to recover $1,100 worth of solar panels at current prices will naturally have a better rating than one which allows investors to recover only $900 worth of underlying solar panels.

[23] *See LDK Solar Gets 2 Billion Yuan Bank Loans After Bond Default*, BLOOMBERG, 2014.

[24] Recent declarations by the State Council (China's supreme executive body) clearly signal the government's resolve to continue to support the industry. *See China reaffirms support for solar PV industry*, SYDNEY MORNING HERALD, 2014.

Hong Kong financing and securitisation firms can offer economies of scale in securitisations which US investment firms would find hard to match.[25] As we previously showed, the solar financing market in the US still rests at a nascent stage – with markets divided by state.

These Chinese experience shows vividly that scaling-up can occur quickly -- offering a potentially larger market China than even the US or the EU. Third, and related to these points, the lack of customer credit histories represents a far less problem for Hong Kong investors than US investors. Credit rating agencies – like Standard & Poor's – have noted that lack of credit histories for solar assets make these assets hard to rate (and thus price).[26] Given implicit guarantees by the Mainland government and potential to attract investors who best know the risks, the risks seem remote.[27]

Hong Kong provides a superior venue for selling solar securities than the US for other reasons as well. First, the reliability of long-term cash flows has bedeviled the US solar market for some time.[28] With rental contracts at 20 years and average homeownership tenures at 13 years, the mismatch between ownership tenure and lease period creates a risk. However, such moves are less frequent on the Mainland. Second, solar panel producers and operations companies achieve significant cost-savings (and thus higher profitability) on larger scales. We already provided data showing China's strong advantages in certain export markets and parts of the solar supply chain. We also showed data indicating that the largest Chinese solar companies split their listings between Hong Kong and New York. As the Mainland solar industry consolidates, having a single source of equity, debt and securitised debt funding (namely Hong Kong) could provide benefits for aggregators and specialists working in Hong Kong.[29] Third, solar financing could benefit from standardized documentation and systematized due diligence – both of technological specifications as well as the financing documents underpinning the installation of that technology. Such standardisation is much easier in a city-state than in a country spanning 50 different legal systems and hundreds of solar entities

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[25] Borod worries that that even the US's potentially large market for securitised solar assets would not achieve sufficient scale to attract demand and sufficiently lower origination costs. Citing Bloomberg in 2011, he claims that bond values for securitised rooftop solar panel contracts would come to only about $430 million. The securitisation of all commercial rooftop contracts only brings about $730 million in new solar bonds. These amounts come to much less than the values we presented earlier for securitisations on the Mainland. *See* Ronald Borod, The Devil in the Details of Solar Securitization, 39 PRACTICAL INTERNATIONAL CORPORATE FINANCE STRATEGIES 7, 2013.

[26] *See* Andrew Giudici, Jeong-A Kim, Brian Yagoda, *Will Securitization Help Fuel the U.S. Solar Power Industry?* 2012.

[27] Increasing Hong Kong's securities markets will, hopefully, attract more Mainland institutional investors who can monitor risks more closely.

[28] *See* Borod at 2.

[29] Borod refers to this as an "aggregation facility."

(namely the US). If Hong Kong can quickly settle on such standards for the Mainland before US firms can agree on such a standard, Hong Kong standards could even affect the trajectory of market development. Fourth, the US Dodd-Frank Act requires the sponsor to hold at least 5% of the risks associated with any securitisation.[30] Hong Kong does not require such potentially costly risk-retention -- making Hong Kong a more attractive jurisdiction.

Ⅲ. Lessons of the Minibond Scandal for Developing a Hong Kong Solar Securitisation Market

Despite the promise of photovoltaic securitisation in Hong Kong, many investors do not think of Hong Kong as a securitisation centre due to recent scandals – particularly the Lehman Minibond scandal. Why should investors invest in securitised assets in Hong Kong when such investments have a poor track record? A recent review of securitisation sums up the current situation, "securitisation professionals are continuing to have to look elsewhere in the region for deals given the extremely low level of activity in Hong Kong."[31] The financial crisis – combined with the Lehman mini-bond crisis – led to regulators' and buyers' wariness of structured investments – including asset-backed securities of all types.[32] Such wariness comes from lumping together asset-backed securities with structured products. **Asset-backed securities** (like solar bonds) use assets as collateral and as underlying producer of the revenue streams ultimately thrown-off by the securities themselves. To take an example from a recent SolarCity solar bond, "the trust estate [the legal entity used to hold the underlying asset] will consist primarily of all rights, title, and interest of the issuer in a portfolio of solar assets, including customer agreements, solar equipment, permits, manufacturer's warranties, and cash flow associated with the ownership of such assets" (bracketed material ours).[33]

Solar Funding I and Solar Funding II also represent examples of securities (in this case debt-securities) using secured assets to back a medium-term note. **Structured finance** usually involves the use of derivatives whose pay-offs depend on particular events – like the continuing existence and operation of a

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[30] *See* Borod at 2.

[31] *See* Adrienne Showering and Paul McBride, *Securitisation in Hong Kong,* In Stephen Jaques, GLOBAL SECURITISATION AND STRUCTURED FINANCE 2008, 2008.

[32] We do not have the space to describe the Minibond scandal. For an overview, *see* Elvin Edwards, *An overview of the Lehman Brothers minibonds saga*, FRESHFIELDS BRUCKHAUS DERINGER, 2008.

[33] For an analysis of the instrument, *see* Xilun Chen and Weili Chen, *SolarCity LMC Series I LLC (Series 2013-1)*, STANDARD&POOR'S, 2013.

particular solar company or asset.[34] Packagers often structure these securities like bets -- in order to provide investors with "pure" exposure to certain risks (and rewards) that holding assets and liabilities directly cannot provide.[35] Solar assets might be structured through "tranching" asset-backed securities (like receivables) into groups with differing risk profiles (as we have illustrated in the examples in the previous sections). In theory, underwriters can write derivatives which pay (or don't pay) depending on any risk chosen in the structured product document.

Yet, the Minibond crisis illustrates the need to adequately regulate securitisations in Hong Kong – rather than just continue to work around existing rules and adapt in a piecemeal fashion. The marketing materials themselves provide a perfect illustration of how the structured product promoters did not market to the right people with the right product. Figure 7 shows an example of an advertisement used to market the Lehman minibonds.[36] The ad illustrates our paper's thesis – that policy should encourage banks and broker- dealers in a financial centre to focus on targeting the right investors with the right products. Financial sector policy (and thus law) encouraged marketing minibonds to the general public – rather than targeting individuals who could use their profile of risks and returns to complement other portfolio holdings.[37] Structured products did not cause the mini-bond crisis. The nature of the minibonds and the marketing process itself caused the scandal.

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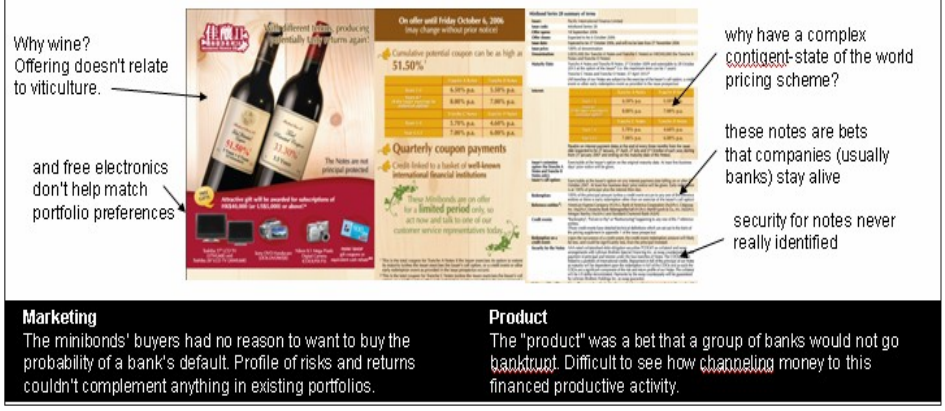
[34] For more, *see* Joshua Coval, Jakub Jurek and Erik Stafford, *The Economics of Structured Finance*, HBS WP 09-060, 2008.

[35] For example, a solar-backed structured product could pay 5% if the underlying solar assets yield 9% or nothing if they yield less. Such a bet allows investors to increase their risks (and thus returns) – while offering the securities' originators the opportunity in profit in case the assets are only mildly profitable.

[36] We provide a superficial description of the problems associated with these advertisements in order to focus on our own paper's thesis. For a detailed discussion of the problems with the advertising regime in place at the time, *see* Andrew Godwin, *The Lehman Minibonds Crisis in Hong Kong: Lessons for Plain Language Risk Disclosure*, 32 UNSW L. J. 2, 2009.

[37] The SFC, looking for legal rather than structural problems, cited misrepresentation in the sales process, the complexity of the structured products themselves and lack of suitability assessment as the main drivers of the scandal. Their response consisted of increasing the hurdles to purchase, while remaining faithful to a regulatory regime based on disclosure rather than ex-ante rules. If policymakers stepped back and asked what the sale of structured products hoped to achieve in the broader financial system, their recommendations might have been more similar to the ones we make in this paper. *See Issues Raised by the Lehman Minibond Crisis: Report to the Financial Secretary*, SFC, 2008.

Figure 7: Minibonds Sold Speculative Bets, Not Shares of Productive Investment



The nature of the minibonds (and other structured products) sold shows how the very philosophy of Hong Kong's structured products market has moved away from intermediating funds and towards betting. Figure 8 shows the types of Lehman Brother structured products offered during the Minibond crisis; while Figure 9 shows the companies which had to go bankrupt in order for the bonds not to pay off.[38] The value of Lehman Minibonds equalled roughly the annual turnover of the Las Vegas Sands (casinos). Each of the series amassed large amounts of investments in securities without any solid underlying assets. Moreover (as shown in the second part of the figure), investors in Hong Kong bet primarily on banks located thousands of miles away.

Standard Chartered, HSBC, Citigroup and Bank of America represented the most frequent "reference entities" which investors would wager would not go bankrupt. Hutchinson Whimpoa represents the only "productive" (from the perspective of making goods and services) company on the list.[39] Financial regulation did not represent the core problem of the crisis. Financial and other institutions which stoked demand and encouraged the supply of inherently unproductive financial securities led to the crisis. Yet, Hong Kong's securitisation law failed to provide ways of cheaply and effectively matching supply of productive assets with demand.

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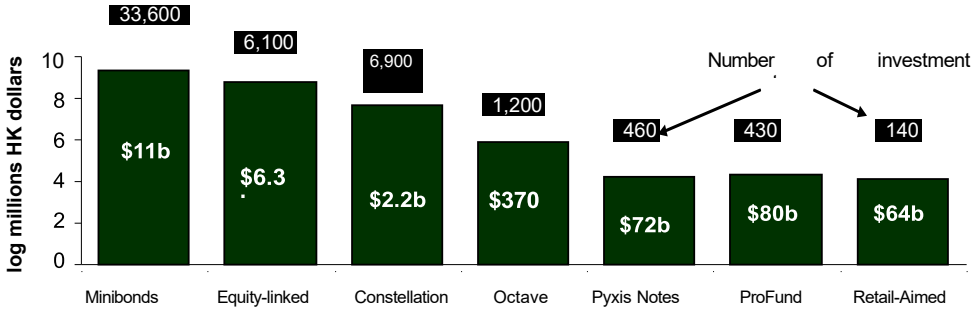
[38] *See Report of the Subcommittee to Study Issues Arising from Lehman Brothers- related Minibonds and Structured Financial Products*, LEGISLATIVE COUNCIL OF THE HONG KONG SPECIAL ADMINISTRATIVE REGION, 2012.

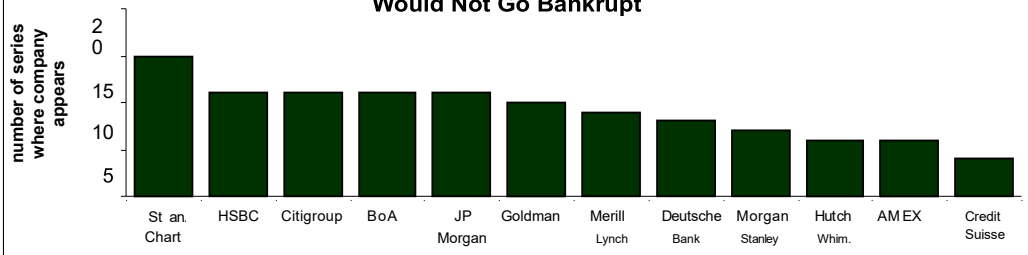
[39] Economists see the resources spent by banks and other sectors like security services as "transactions costs." In this view, these intermediaries produce nothing directly – instead, allow for other sectors of the economy to operate more efficiently.

Figure 8: Hong Kong's Structured Investment Market Focused on Linked Noted Rather than Securitisations of Actual Assets



The figure shows the value of outstanding Lehman Brothers products distrubuted by banks. The size of the figures alone shows why structured products should slice-and-dice real assets -- as their total comes to about 20.2 billion HKD (or US$2.6 billion). Source: Hong Kong Legislative Council at Appendix 2b.

Figure 9: Hong Kong's Structured Products were Bets that these Companies Would Not Go Bankrupt



The figure shows the number of times a company appears as a "reference entity" in series 16-36. Minibond holders receive no pay-off if these reference entities go bankrupt -- in effect making the minibond a bet rather than channeling money to productive investment. Source: SFC Website.

The Government's piece-meal approach (focusing on the best practice sales processes and legal provisions) – rather than taking a systemic view of the marketing of structured products in general – will not help develop Hong Kong's financial markets.[40] The Legislative Council and Securities and Futures

[40] Linklaters provides an excellent overview of the proposals made in response to the Minibond crisis and the Government's focus on sales processes and potential fraud. *See* Linklaters, *Legco Report – Impact on Providers and Distributors of Structured Financial*

Commission have claimed that "many lessons have been learnt" from the crisis. Figure 10 summarises the major regulatory changes based on the lessons from the Minibond scandal.[41] In order to make our discussion more concrete, we focus our discussion of these proposed changes on their likely effect on the development of vibrant financial markets in solar (photovoltaic) assets. Many of the Government's proposed reforms will likely make the offer of photovoltaic structured instruments more difficult – without increasing investors' safety.

Figure 10: Selected Proposed Reforms Still Don't Focus on Real Economy

Item	Description and Impact on Solar
Single SFC Handbook	Adoption of single rulebook presumably consolidates rulemaking and increases compliance. In itself, it is a cosmetic remedy.
Key Fact Statements	Plain-language, fact statements will allow investors to assess investment risks and returns more easily. A glance at these statements shows, despite plain English, still long and complex.
Oversight of product arrangers	Product arrangers should be based in Hong Kong and overseeable by SFC. Such an action focuses on enforcement, but not on SFC's role in promoting development of cooperation with those it regulates.
Eligibility for issuers, guarantors and arrangers	These classes of arrangers are prohibited from engaging in activities if they have disciplinary action against them. Naturally, this would help solar market providers – particularly if they plan to make requirements easier for retail access to solar securities.
Collateral	Securitised issuers would need to hold collateral against securitisations. Collateral would raise costs and hurt securitisations.
Investor classification	Requires testing of investors' product knowledge and risk profit (suitability). For mis-selling would help. But wouldn't help protect investors who want to take genuine risks.
Disclosure of commissions	Securitised products' distributors should disclose commissions. Such disclosures probably very important if target retail and international investors in a special regime (as we propose in this paper).
Post-sale obligations	Requires on-going communication of updated financial information, potential risks, liquidity and so forth.

Products, 2012.

[41] *See* Alan Ewins, Catherine Husted, Juliana Lee and Joyce Woo, *The Lehman Aftermath: Hong Kong and Singapore Regulatory Reforms in the Structured Product Markets World*, 5 CAP. MAR. L. J. 3, 2010.

Cooling-off period	Provides investors with chance to change their mind (within a certain number of days). Probably good for solar investors – as risk of losses low and need investors which understand their purchase.
Safe harbours	Hong Kong has had difficulty in defining safe harbour areas. As we describe in this paper, extending safe harbour provisions probably good for markets.
Authorisation for marketing materials	Given increased SFC surveillance, can move to post-vetting system – fining firms marketing solar products which violate requirements.

Based on Ewins et al. (2010)

Most commentators rightly – if maladroitly – point out that a regulatory regime which discouraged the production and use of simple and useful information helped add fire to the scandal. Godwin represents one of the most vocal academics arguing for the simplest possible descriptions of the securitised products that investors buy.[42] They also criticises that the SFC's proposed rules will not improve clarity, simplicity and usefulness of investor information.[43] Neither will the HKMA's recommendations – which aim at everything -- producing "health warnings" labels on documents, audio recordings of sales meetings and detailed customer risk assessments. [44] Nothing in the recommendations addresses the fact that structured product information materials do not tell investors what assets they are buying and whether they match the portfolio needs of the investors.[45]

Current structured products materials on file with the SFC probably reduce participation in structured products without necessarily improving investors' knowledge of the mechanics of the investment. Figure 11 shows a sample of investor materials from the SFC's List of Investment Products. As shown from this random sample, the informational materials – while written in simple English – still provide a great deal of information without simple overviews of

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[42] *See* Andrew Godwin, *The Lehman Minibonds Crisis in Hong Kong: Lessons for Plain Language Risk Disclosure*, 32 UNSW L. J. 2, 2009.

[43] *See* Will Shen, *When Complexity Impairs Disclosure – A Critique of SFC's Proposal to Strengthen the Disclosure Regime after the Lehman Minibonds Incident in Hong Kong*, 23 EURO. BUS. L. REV. 6, 2012.

[44] HKMA, *Report of the Hong Kong Monetary Authority on Issues Concerning the Distribution of Structured Products Connected to Lehman Group Companies*, 2011.

[45] The SFC's recommendations encouraged investment advisors to conduct suitability checks, in part based on observations from authors like Chang et al. – who found that investors buy more structured products when investment advisors do not check for suitability. As we argue, investors should not merely be "suitable." Structured products should contribute a risk-return profile to their existing portfolio in a way that adds value to the investors' portfolios and provides the company which securitised its assets some competitive market advantage. *See* Eric Chang, Yongjun Tang and Miao Zhang, *Suitability Check and Household Investments in Structured Products*, 2013.

how the investment works. These voluminous materials use plain English but, they clearly seem written in a way which protects the writer from liability, rather than informing clients what their money is used for.

Figure 11: Structured Product Investment Materials in Plain English, But Still Don't Describe the Actual Investments

Non-Principal Protected Unlisted Daily Accrual Equity Linked Investments Linked to a Basket of Securities with Call Feature and Optional Knock-In Feature	Product booklet – Programme Memorandum–	229 pages 29 pages
Non-Principal Protected Unlisted Callable Equity Linked Investments Linked to a Single Security	Financial Disclosure Document – Product Booklet – Programme Memorandum–	177 pages 148 pages 25 pages
Non-principal Protected Unlisted Callable Equity-Linked Investment Contracts with Potential Cash Distribution linked to a Basket of Stocks	Financial Disclosure Document – Offering Circular – Product Document –	245 pages 51 pages 175 pages
Non-Principal Protected Unlisted Bull Equity Linked Investments Linked to a Single Security	Term Sheet – Product Booklet – Programme Memorandum–	7 pages 57 pages 206 pages
Non-Principal Protected Unlisted Equity Linked Investments linked to a Single Stock Bank of China	Financial Disclosure Document – Information Memorandum– Product Booklet –	383 pages 23 pages 168 pages

The figure shows a random sample of structured products as reported in the SFC's List of Investment Products. Structured deposits and page counts for product addenda were excluded.

As we shall see in the next section, lack of specific information is not specific to structured products. Hong Kong markets in general provide far less useful information to investors than those of the US or UK. Hong Kong's financial law dictates the incentives to produce investment information. Such financial law falls behind that of the US and UK when judged by the quality and reader-friendliness of such information.

Ⅳ. Developing Information Markets for Mainland Solar Securities

Deep "investment information markets" can promote the development of Hong Kong as an international financial centre – not only for solar securities but for all kinds of securities.[46] Financial law which promotes the generation of insightful, reader-friendly and useful company analysis would likely have three effects on the depth of Hong Kong's financial markets.[47] First, increasing the amount of information simple enough for retail investors would likely grow demand for Hong Kong securities by professionalor institutional investors. They often look at the same information sources (like *Seeking Alpha* and the *Wall Street Journal*) and other sources that retail investors do.[48] Broadening information sources about Hong Kong-traded securities and companies (and solar companies in general) can only enhance overall financial market liquidity and promote efficiency.[49] Second, having a lot of people writing about Hong Kong-listed and traded securities makes secondary market sales easier and priced better.[50] Lack of information leads to selling "lemons," which results in adverse selection and moral hazard in offering and buying securities.[51] Having vibrant information markets in Hong Kong-traded securities would reduce investors' reliance on any one source of information -- and possibly even improve investors' performance.[52] Third, observing how others react to

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[46] We refer to investing information "markets" throughout this paper -- as the production and consumption of such information clearly follows market principles. The value of such information depends on its supply and demand and commands a price (even if payment for such information often occurs during the sale of the investments themselves).

[47] More and better information about Hong Kong securities can only benefit investors and companies themselves. For proof of this self-evident statement (albeit from a US context), *see* Brian Bushee, John Core, Wayne Guay, and Sophia Hamm, *The Role of the Business Press as an Information Intermediary*, 48 J. OF ACC. RES. 1, 2010.

[48] Indeed, institutional investors spend more time looking at financial media, making the value of such information even greater. Barber and Odean find that institutions may consume more of such information and use it better. *See* Brad Barber and Terrance Odean, *All That Glitters: The Effect of Attention and News on the Buying Behavior of Individual and Institutional Investors*, 21 REV. FIN. STUD. 2, 2008.

[49] Returns to investors on stocks which the media generally does not cover exceed those which the financial media covers. This implies that investors have special information. Thus, expanding the amount of information to retail investors about securities would remove these profitable (and presumably unfair) information asymmetries. *See* Lily Fang and Joel Peress, *Media Coverage and the Cross-section of Stock Returns*, 64 J. OF FIN. 5, 2009.

[50] Numerous studies find that webboard and other postings have a statistically significant (albeit small) effect on equity prices. See Werner Antweiler and Murray Frank, Is All That Talk Just Noise? The Information Content of Internet Stock Message Boards, 59 J. OF FIN. 3, 2004.

[51] For an example of this problem in the mortgage-backed securities financial services segment, *see* Chris Downing, Dwight Jaffee and Nancy Wallace, *Is the Market for Mortgage-Backed Securities a Market for Lemons?* 22 REV. FIN. STUD. 7, 2009.

[52] In the US, information aggregators have started to consolidate ratings from a wide range of

information can provide as much – if not more – information to investors than financial statements, earnings reports and major company events.[53] Wide-spread media coverage of securities can help bring inside or little-known information in the public's view, increasing the information content of share prices.[54] Hong Kong's securities regulatory regime focuses on disclosure rather than authorisation. For disclosure to work (discipline companies), information needs to be shared and discussed.

At first glance, the quality of information investors receive about Hong Kong-listed solar companies (and companies in general) seems comparable to its larger international financial centre peers like New York. The next three figures show that while the quantity of information about Hong Kong-listed solar companies roughly equals those listed elsewhere, the quality of such information differs. Figure 12 shows the depth of information about major Mainland solar companies listed in Hong Kong and New York. As shown, the number of internet references to various solar panel companies looks similar between Hong Kong-listed and non-Hong Kong listed solar companies.[55] Figure 13 shows the depth of information provided by solar companies listed in Hong Kong and in other jurisdictions. As shown, most US-listed solar companies have some form of web- casting of financial, operational, and other results. Hong Kong-listed Mainland solar companies often provide very little information. Figure 14 represents one example of the general trend in Hong Kong to provide very succinct information about companies. The information provided by both the companies themselves and their analysts consists of two or three line announcements about earnings or major news events. The telegraphic analysis favoured in Hong Kong likely results in part from its financial law.[56]

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analysts into "consensus forecasts." Acaedmics have not yet definitively established whether the performance of such consensus estimates and analysis based on the aggregation of analysts' analyses beats individual estimates. Yet, the high demand for such aggregation in the US shows that investors value these services. See

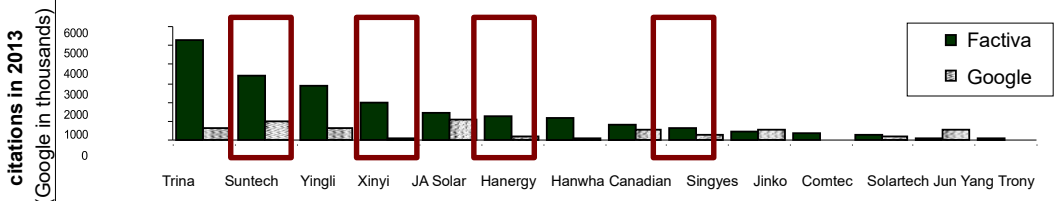
[53] For one study, *see* Timothy Pollock, Violina Rindova, and Patrick Maggitti, *Market Watch: Information and Availability Cascades Among the Media and Investors in the U.S. IPO Market*, 51 ACAD. MANAGE. J. 2, 2008.

[54] *See* Paul Tetlock, *Does Public Financial News Resolve Asymmetric Information?* 23 REV. FINANC. STUD. 9, 2010.

[55] As with previous examples, given the unscientific nature of the data used, we did not conduct more sophisticated statistical tests of similarities and differences between these two groups.

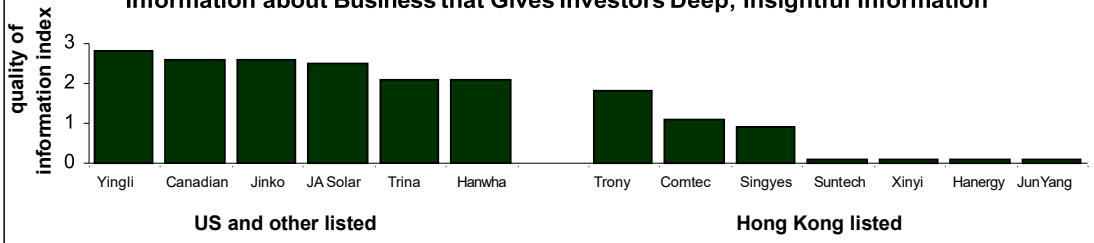
[56] Market practices respond to incentives given by law (and other institutions). If we observe market equilibrium practices as providing very short analytical and informational pieces, we assume market actors behave according to the incentives they face.

Figure 12: A Hong Kong Listing Does Not Dampen General Discussion about Solar Shares



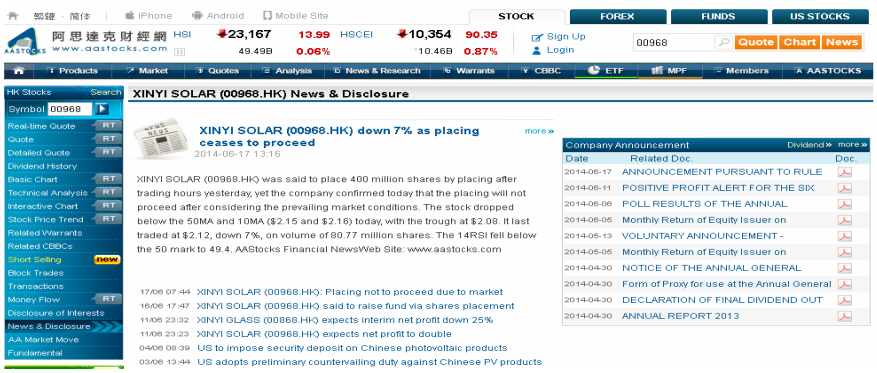
The figure show s general media citations about each company in 2013. Dark green bars show citations in the world's English language press, while dotted black bars show Google cites (in thousands). Source: Factiva and Google(2014).

Figure 13: Hong Kong Listed Companies Never Provide Webcasts and Deep Information about Business that Gives Investors Deep, Insightful Information



The figure shows the extent and depth of Mainland solar companies' financial reporting to investors. Companies receive one point for providing webcast presentations of their financial reports and investor conferences, one point for additional presentations about their recent performance, and one-tenth of a point for the number of analysts covering the company. Source: company websites.

Figure 14: News About Hong Kong-Listed Mainland Solar Companies Usually Telegraphic Flashes Instead of Deep Analysis



The availability of information and the geographical location of investors using an international financial centre likely go hand-in-hand. Figure 15 shows an example of an information source about securities traded in three major international financial centres and the extent of foreign interest in those shares (as proxied by web visits). As shown, Hong Kong websites cater mostly to local or Mainland investors and readers. The US and UK both have significant foreign interest in their securities. US and UK regulators and intermediaries thus have incentives to provide fuller and more accessible information to these foreign constituencies. In contrast, Hong Kong intermediaries focus on domestic investors (and to a limited extent on Mainland investors), whom they can communicate with verbally and in meetings. As a result, they do not need to produce the wide range of publications and analysis that UK and US intermediaries do.

Figure 15: English-Language Internet Resources for US Traders

US	UK	Hong Kong
Seeking Alpha	**Fool UK**	**AA Stocks**
Foreign Visitors: 33%	**Foreign Visitors**: 42%	**Foreign visitors:** 22%
Share*: India (15%), Canada (12%), UK (6%), Netherlands(4%)	**Share***: US (36%), India (6%), France (5%), Canada(4%)	**Share***: China (41%), Macao (14%), Taiwan (7%), US(7%).
Bloomberg	**Financial Times**	**Economic Times**
Foreign Visitors: 53%	**Foreign Visitors**: 82%	Foreign visitors*: 10%
Share*: India (9%), UK (8%), Canada (6%), Japan (6%).	**Share***: US (34%), India (8%), Japan (4%), France(4%).	Taiwan (50%)

* Share represents the share of foreign visitors calculated by dividing the number of website visitors from a certain location by the number of "foreign visitors" (100% minus the share coming from that website's own jurisdiction).
Source: Alexa (2014).

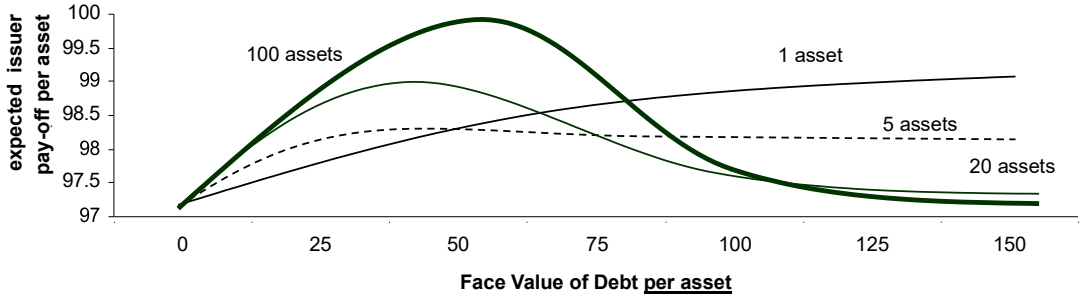
Yet, the generation and intermediation of information about asset-backed securities like solar company assets, liabilities and panels can particularly benefit both investors and issuing companies. Figure 16 shows the superior returns that securitising and tranching assets (like solar assets) can earn because of the information thrown-off (and diversification achieved) in the process.[57] Demarzo's logic (expressed in the solar context) is as follows. Imagine a financial intermediary called Bauhinia Solar Finance has invested in all kinds

[57] *See* Peter DeMarzo, *The Pooling and Tranching of Securities: A Model of Informed Intermediation*, 18 REV. FIN. STUD. 1, 2005.

of solar assets, like panels, machines and so forth. Bauhinia Solar Finance wants to sell securities in these assets. Potential investors in New York, London and Hong Kong however do not know which assets will likely pay-off. The management of Bauhinia Solar Finance however does know. Pooling these assets naturally destroys the value of this information as they can no longer know how the whole asset pool will perform. However, investors may find pooled and tranched securities more attractive.

They know diversification will protect them from Bauhinia egregiously selling them assets they know won't perform. Securitising the assets provides more liquidity as markets for these securities are generally more liquid than markets in share-panel revenue sharing schemes and other revenue participation schemes. Investors in these tranches should — in theory— know much more about the assets in the security than the large bundle of assets used to generate value for normal equities or bonds.

Figure 16: Tranching Securities Throws Off Information Which Investors Can Use to Improve Yields



The figure shows expected issuer returns on pooling assets and selling tranches when the seller has better information about the assets than buyers do. Source|: DeMarzo (2003).

DeMarzo's model provides important insight for Hong Kong's policymakers about the way securitisation and tranching can deepen information markets for securities of all types traded in Hong Kong. In theory, securitisation should provide more information about the kind of assets companies invest in.[58] Pooling assets and tranching them requires originators, intermediaries, investors and rating agencies to make decisions about asset qualities. Yet, in practice, we observe intermediaries adding complexity to the

[58] Asset securitisation should unbundle assets lying in a corporate portfolio and provide returns attached to those assets to specific investors. Thus, in principle, securitisation can provide more information than simple debt or equity investments. *See* Edward Iacobucci and Ralph Winter, *Asset Securitization and Asymmetric Information*, 34 J. OF LEG. STUD. 1,2005.

securitisation, tranching and trading process so as to hide information about their financial transactions.[59] **Despite the inherently information-emitting nature of selling structured securitised products, financial law and custom provide intermediaries with strong incentives to structure these products so as to hide information.** The mini-bond scandal happened because regulators failed to provide market actors with incentives to package and release the information generated by the naturally information-generating process of securitising, tranching and selling structured and securitised products in a way that is easy to understand.

The US provides an example of a jurisdiction realigning the incentives financial law gives to release information contained in a securitisation process. Academics like Booth have chronicled the way that inflexible financial law can retard the development of sunrise industries like solar energy.[60] She militates for wide-sweeping changes in financial law to accommodate "community solar" (namely financing arrangements which allow communities to invest in solar projects and receive the benefits collectively). She describes several channels for such change, including changing state "Blue Sky" laws and relaxed SEC crowdfunding rulemaking. She also encourages increased and easier use of Regulation D (offerings to "accredited investors"), the Intrastate Exemption (which allows relaxed offering rules as long as securities are marketed only intrastate), as well as the repeal of the non-solicitation rule and an expansion of Blue Sky laws.[61] At the risk of over-simplifying her argument, the best way to encourage the development of solar financing consists of encouraging companies to provide complete and informative information, and to rely on anti-fraud rules (rather than elaborate prescriptive rules) to guide and discipline market actors. Delimatsis also argues for relaxed financial rules governing the finance of sunrise industries like renewable energy.[62] These two voices represent examples of a chorus of academic and professional commentators who argue that financial law needs to adapt to the needs of new technologies (like solar energy and broader investor participation in it). The solar sector best illustrates how a new and innovative industry can provide

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[59] *See* Mei Cheng, Dan Dhaliwal and Monica Neamtiu, *Banks' Asset Securitization and Information Opacity*, 2008.

[60] *See* Samantha Booth, *Here Comes the Sun: How Securities Regulations Cast a Shadow on the Growth of Community Solar in the United States*, 61 UCLA L. REV. 760 (2014).

[61] For Regulation D, *see* 17 C.F.R., at sec. 230.504–6, 2013.For the Intrastate Exemption, *see* 15 U.S.C. sec. 77c(a)(11), 2012, [also called the Section 3(a)(11) exemption after the original piece of legislation].

For state Blue Sky law exemptions (also known as Rule 504 exemptions), *see* 17 C.F.R. sec. 230.504(b)(2), 2013.

[62] *See* Panagiotis Delimatsis, *Promoting Renewable Energy Through Adaptive Prudential Regulation in Financial Services*, TILEC DP 2010-017, 2010.

incentives which encourage financial regulators to adapt "contingently" (to use our term and in contract to the "structuralist" approach).

Ⅴ. What would the final solar energy investment scheme look like?

An information rich environment can improve the sales and liquidity of all kinds of financial services markets including markets for solar-backed assets and liabilities.[63] As we have argued, financial policy (and thus law) should encourage the generation of information which help financial service providers match solar assets and liabilities to investors' current portfolio needs. Before we can describe the kinds of legal changes needed to bring about a "better" market for sunrise industries (like solar), we need to describe what such a market would look like. Figure 17 provides an example, based on California's experience, of investment information provided by crowdfunder Mosaic.

Mosaic has received about $20 million from private investors and from the US government to develop solar-related investments worth in excess of $100 million.[64] While Mosaic currently aggregates small amounts of money for small investors, there is no reason why such a scheme cannot apply on a large-scale.

Projects are listed by location, accompanied with graphics and information on funding status. In this way, investors can clearly see where they are investing, in which project, and which state residents are accepted. Transparently listed yields mean potential investors do not need to dig around a term sheet to find out what the true yield is. Prospectuses are available from clearly visible links.

Signing up consists of a one-click process, taking the hassle out of investing for a wide range of potential investors. No need for free product give-a-ways or other tricks that plagued Minibond offerings. Investors can see the potential yields, terms, and how much funding has been received. Specific investments can even be excluded to certain investors (those in jurisdictions with regulations prohibiting such sales). Automatic exclusions can reduce policing time and costs.

The site provides technical information on the asset such as electricity generation capacity, number of panels, warrantee time, and so forth. No long legal language, just facts about the assets themselves. The platform also offers resources which help investors understand what they read and help

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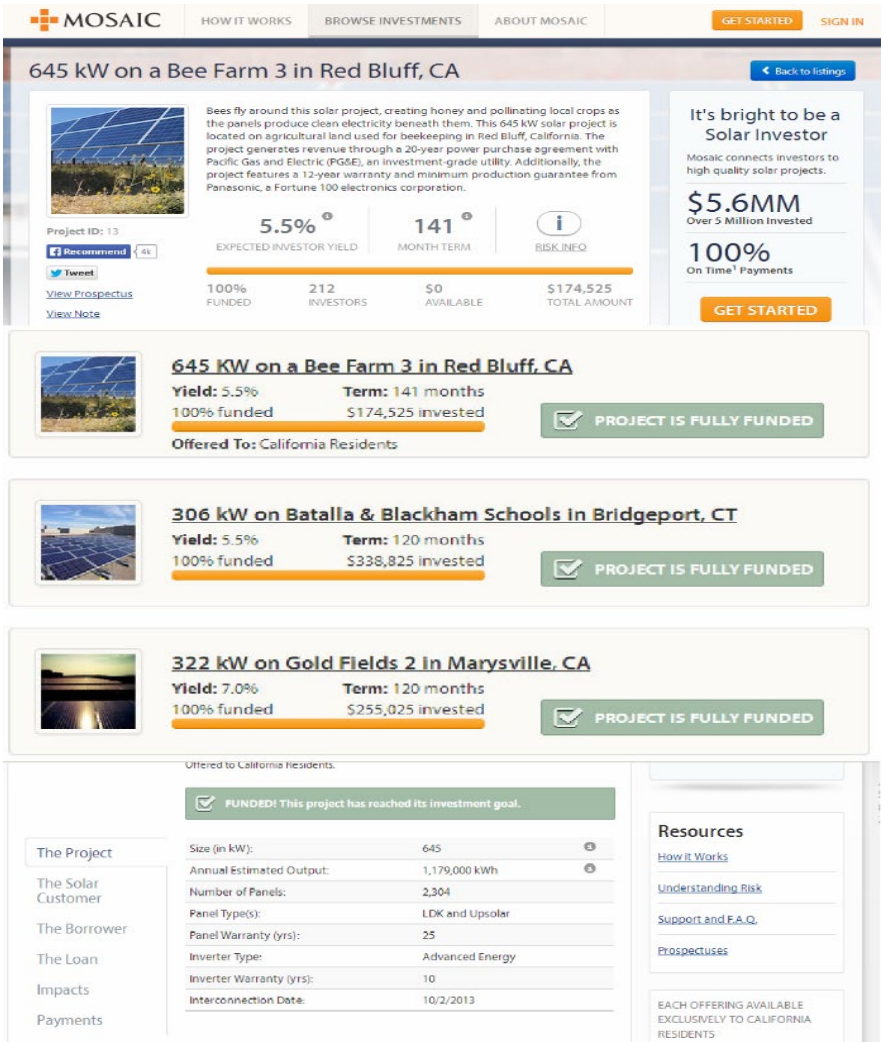
[63] In this section, we ignore the legal issues to focus on what an idealised solar investment service might look like. We discuss legal issues in a later section.

[64] *See* Andrew Herndon, Solar Mosaic's Crowdfunding Beats Treasuries With 4.5% Return, Bloomberg, 7 Jan, 2013. *See also* Wendy Koch, U.S. solar projects get lift from online tool, USA Today, 17 June, 2014.

them get more information. No trolling around a regulator's database.

Figure 17: Offering Solar Investments Based on California-Based Mosaic's Experience



Source: Mosaic (2014). We have no business or investment relationship with this company and receive no commissions or other rewards for discussing this example.

The Mosaic example shows three attributes of market design (particularly for securitised assets) which improve the quality of financial information about the market.[65] First, crowdfunding platforms like Mosaic show exactly which assets investors purchase and what they will be used for.[66] Second, they facilitate the trade of assets rather than stocks and bonds. Investors using the Mosaic platform obtain stakes in hard assets, not opaque companies which bundle assets and liabilities together.[67] Third, a solar platform like Mosaic encourages public discussion about specific assets and the development of the solar industry in general. Proof of viability also encourages market entrants, deepening the market and thus improving the quality of markets.[68] These principles emerge most clearly in crowdfunding. Yet, there is no need to confine these principles to small-scale, community investment. The development of a Mosaic-like entity in Hong Kong represents a public good which could help improve the quality of market information and market participation.

As we have argued, an international financial centre's law should be developed to be in line with the supply and demand of securities – instead of simply striving to maintain the status quo. Crowd-funding platforms (like Mosaic) which have developed in California show the importance of market needs, instead of focusing on historical or "best practice" financial laws or adopting Financial Stability Board recommendations. New technologies in California, combined with heavy-handed business regulations, have led to crowd-funding movements which entered the US federal law and subsequently California law.[69] Financial legislations in the US, in particular, are redefining

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[65] We take these three attributes from the broader policy literature. Many governments have started consultations for developing a crowdfunding policy, as crowdfunding increases participation and transparency of certain types of speculative investments. However, we want to focus on broader attractive elements of the developments in crowdsourcing policy (and law) which be applied to financial law more generally. *See* Kristof De Buysere, Oliver Gajda, Ronald Kleverlaan, Dan Marom, and Matthias Klaes, *A Framework for European Crowdfunding*, 2012.

[66] We put the word investor in quotes as many crowdfunding platforms treat investments as charitable contributions in order to circumvent securities regulations. *See* Edan Burkett, *Crowdfunding Exemption - Online Investment Crowdfunding and U.S. Secrutiies Regulation*, 13 TENN. J. BUS. L. 63, 2012.
Crowdfunding Exemption - Online Investment Crowdfunding and U.S. Secrutiies Regulation, A.

[67] Mosaic has already encouraged large solar companies to follow its example. SolarCity has announced plans to offer Mosaic-style asset-backed obligations to investors. *See* Christopher Martin, *SolarCity Plans to Offer Asset-Backed Debt to Retail Investors*, BLOOMBERG 15 JAN., 2014.

[68] At the time of this writing, SunFunder and Crowdsun had entered the market to compete with Mosaic. Literally hundreds of start-up solar crowdfunding sites have arisen in response, including of RE-volv and Everybody Solar.

[69] We do not have space to describe the background to the law. However, we should highlight that many observers point to a café in Silicon Valley (Oakland California) as the start of the crowd-funding movements. *See* C. Steven Bradford, The New Federal Crowdfunding

that "who" (and more importantly "what") refers to a broker-dealer in response to the sunrise industry.[70] Indeed, most commentators argue that regulations are requiring open websites and transparency server as a *sin qua non* for any rulemaking in this area.[71] Innovation in California (and elsewhere where proponents of crowdfunding seek to raise funds) creates new and less-understood technologies. Crowd-funding offers the advantage of producing and offering extensive information about these new investments while presenting the opportunities to invest in the assets themselves as well. In such an environment with abundant information, regulators have smaller need to adopt specific requirements for governing the types of disclosure companies make.[72] Such an information regime might help tackle the lack of transparency and other issues which have stinted the growth of Hong Kong's structured products and other securities.

Such regime encourages investors to learn about these products and the broader solar market.[73] Figure 19 provides several examples of online infomediaries which consolidate experts' and users' knowledge and other information about specific securities (mostly equities). These services allow users (both anonymous and registered) to read and discuss the analyses provided by other users and mainstream media outlets. These services rely on three public goods which government policy can help put in place. First, these services are provided with real-time updates regarding changes in securities prices. If Hong Kong were to have similar services, the Hong Kong Stock Exchange would need to develop web-apps which third-parties could download

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Exemption: Promise Unfulfilled, 40 Sec. Reg. L. J. 3, 2012.

[70] *See* Shekhar Darke, *To Be or Not to Be a Funding Portal: Why Crowdfunding Platforms Will Become Broker-Dealers*, 10 HASTINGS BUS. L.J. 183, 2014.

[71] Bradford provides excellent proposals for the provisions for any future crowdfunding regulation. He, like most authors writing about crowdfunding law, argues that such law must require open and plentiful information disclosure. Comparing Mosaic (a crowdfunded asset-backed asset site) with MarkIt (a proprietary site providing information about asset-backed and other securities) shows how promising the development of asset-backed securities markets following the Mosaic example can be. *See* Steven Bradford, *Crowdfunding and the Federal Securities Laws*, 2012 COLUM. BUS. L. REV. 1, 2012.

[72] Many of these community-based funding schemes produce so much information that academic authors strain to describe what information companies must provide. For authors like Ellenoff, regulatorily required information consists of the basics like financial information. *See* Douglas Ellenoff, *Making Crowdfunding Credible*, 66 VAND. L. REV. 19, 2013.

[73] A regime which encourages the creation, dissemination and discussion of new investments does not need to run counter to an international financial centre's existing law and regulatory traditions. For example, the UK Financial Conduct Authority has proposed a range of measures aimed at promoting crowdfunding which follows the UK's and EU's existing legislation and regulatory traditions. *See* UK Financial Conduct Authority, *The FCA's regulatory approach to crowdfunding (and similar activities)*, 2013.

and utilize as a platform for query – preferably free of charge. Second, public policy would need to provide free infomediary services until they build a sufficiently large mass of potential paying users to use a fee-plus-free model of information provision.[74] Seeking Alpha charges for PRO users and Yahoo offers investment reports and other services for a fee. By attracting the attention of a large market, a publicly supported platform can crowd-in sellers of company information and analysis.[75] Third, government policies should encourage financial institutions as well as individuals to share their analysis and other information online. Far fewer research reports cover Hong Kong companies compared to US companies. As for services such as Thompson Reuters, their reports on Hong Kong companies tend to be much briefer and less insightful than those which cover US companies. To highlight once more, a body like the Financial Services Development Council can encourage financial institutions to release more of their research to the public.[76]

A Hong Kong franchise of the popular Seeking Alpha site could start focusing on solar stocks – and move out from there. With a proven business model and extensive participation, a Hong Kong affiliate could raise awareness about securities on offer across all industries.

Independent experts and even amateurs can post views about securities. Each writer has its own constituency, while appealing to the broadest readership. This provides participation and a range of views. In the US's information rich environment, much of the service remains free.

Information aggregators provide investment information to easily digest forms. Yahoo, Google, and other aggregators all provide financial news – giving information about US securities. They offer far less information about Hong Kong securities. Even retail brokers like E-Trade with the ability to trade Hong Kong shares provide relatively little information about Hong Kong shares Information aggregators like Morningstar (and others) provide value-added services that Yahoo and Google do not. By increasing the demand for Hong Kong securities information, the Financial Services Development Council can make infomediaries like Morningstar profitable in the Hong Kong context.

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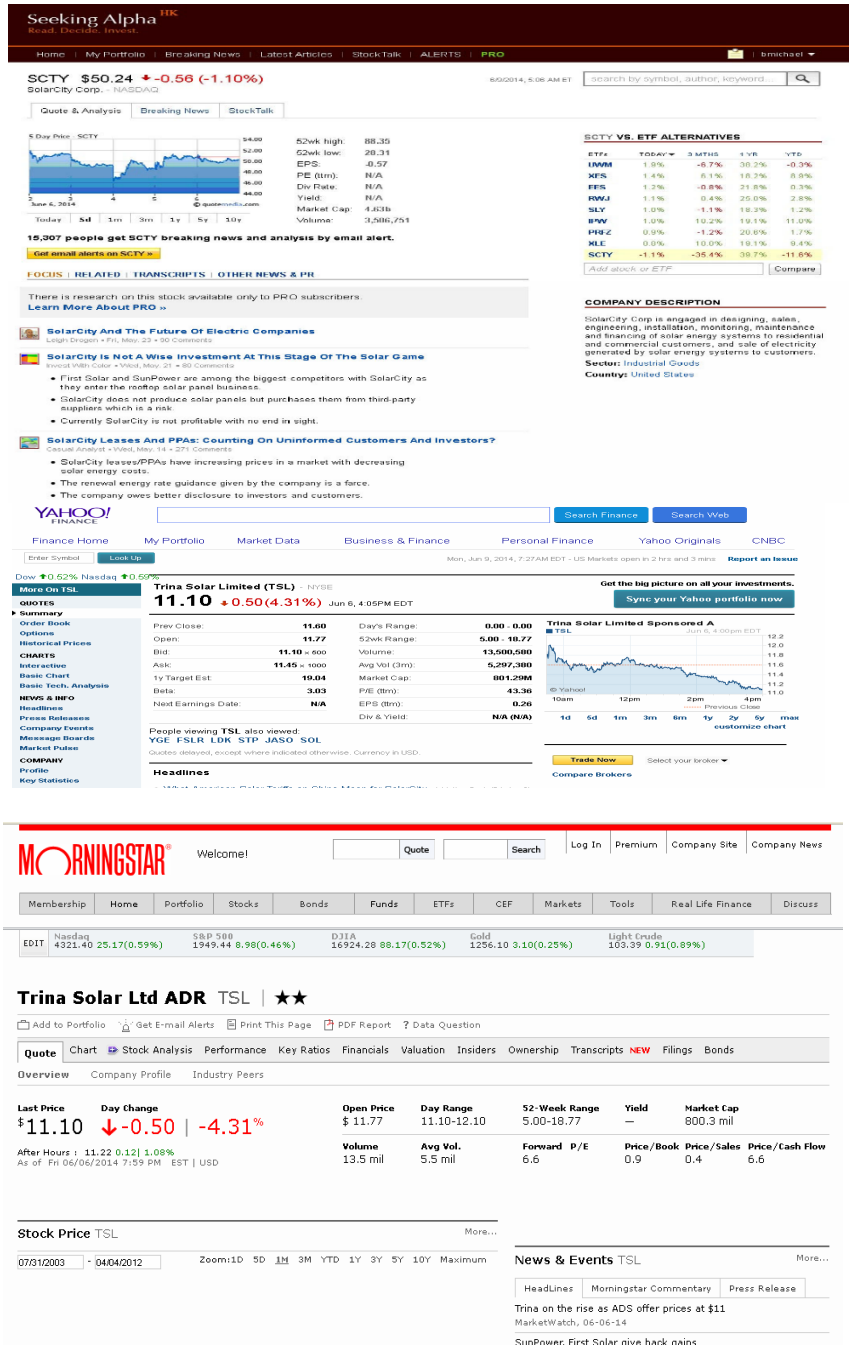
[74] Under free-and-fee based pricing, fees collected from those with the highest income, lowest price elasticity of demand, and most demanding customers would help pay for free services provided to the public.

[75] Many scholars have written about the economics of selling digital goods (like information about securities traded in Hong Kong). Selling information goods often requires versioning of free and paid content. For the bible of information marketing and economics, see Carl Shapiro and Hal Varian, INFORMATION RULES, 1998.

[76] Releasing research represents the typical collective action problem. If HSBC (for example) releases analysis for free while other institutions (like Standard Chartered) do not, investors value HSBC's analysis less. By agreeing as a group to release parts of analyst reports, allow limited blogging by staff and so forth, coordination between financial institutions can help increase the market for financial information in Hong Kong.

Figure 19: What Would Infomediary Discussion of Hong Kong-listed Solar Assets (and Liabilities) Look Like?



Information provision about these investments in Hong Kong – at least in the short-term – represents a public good. Developing deeper information markets clearly requires a certain degree of policy intervention by the Financial Secretary.[77] The current market is not big enough for private companies and organisations (like the ones we have mentioned) to attract investors. As such, Hong Kong policy needs to encourage the development of these categories of infomediaries (like Mosaic, Seeking Alpha, and so forth).

VI. Conclusion

The gist of encouraging the development of solar-related finance in Hong Kong is to focus on the needs of solar companies and their financie rs. Many have already argued that the government needs to take a proacti ve role in encouraging the development of the sector.[78] Yet, developing a large solar panel production cluster in Hong Kong seems unlikely.[79] Hong Kong's financial institutions should focus on funding Mainland initiatives rather than (or in addition to) Hong Kong ones. Jian-ming Zheng (a prop erty tycoon) made headlines recently by pledging about US$530 million t o buy Mainland solar-related assets.[80] Bloomberg reports his state in Shun feng Photovoltaic International rose more than 2,900% -- clearly showing the profitability of investing in Mainland solar assets.[81] Yet, Hong Kong s ecurities laws have not helped investors like Zheng -- and millions of oth ers -- make these investments.

Part of the problem revolves around Hong Kong's legal conceptions of what constitutes security investors' preference for investment. In the past 5 to 10 years, the US and UK have modernised parts of their securities law to promote the development of sunrise industries – prompting some scholars to

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[77] Many think of a stock exchange and the associated organisations providing market information as the pinnacle of free-market principles in action. In fact, these institutions have traditionally emerged as self- regulating public organisations (and later as the result of public policy) to solve collective action and coordination problems. *See* Craig Pirrong, A Theory of Financial Exchange Organization, 43 J. of L. & Econ. 2, 2000.

[78] For example. *see* Stephen Thompson, *Why Hong Kong should be China's green-energy leader, and what we can do*, SCMP 11 MAY, 2014. *See also* Anthony Dixon and Lu Lin, *Hong Kong must warm to the benefits of solar power in future energy mix*, SCMP 1 APRIL.

[79] For more on the recent failure of the Hong Kong-Shenzhen large-scale solar project after one of the largest investors (DuPont Apollo) pulled out, *see* Chi-fai Cheung, *Sun sets on joint Hong Kong-Shenzhen solar project*, SCMP 21 MAY, 2014. For the success of Mainland endeavours, *see* Eric Ng, Solar farm taps crowd funding for 10m yuan project, SCMP 20 FEB., 2014.

[80] Ehren Goossens and Benjamin Haas, *Hong Kong property tycoon betting big on solar rebound*, BLOOMBERG 2 APRIL, 2014.

[81] Id.

engage in a rethink about the nature of securities themselves.[82] These changes take into account new tastes in investing (such as investing directly in assets rather than in stocks and bonds which only give investors an indirect access to assets and liabilities they may be interested in). These legal changes also take into account the fact that some new industries (like internet or renewable energy assets) may require new securities that pass through risks and returns more effectively than traditional stocks and bonds.[83]

In this paper, we have argued that Hong Kong's legal provisions could help intermediate supply and demand for ownership of securitised parts of Mainland solar assets (if judging by other countries' law). We have shown why securitisation represents a key structure for the finance of the solar industry specifically. We showed – by deduction -- that Hong Kong's financial law must be falling down – as its market share keeps falling to rivals and compared to the potential market opportunity available. Lastly, we discussed – using the area of information disclosure – a market-driven regulatory regime for solar-based (and other types) of securitisations in Hong Kong. If regulators can design regulations to channel supply and demand cheaply and effectively, Hong Kong can become a global securitisation financial centre. If not, it is highly likely that New York and London will continue to dominate the global securitisation market.

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[82] *See* Thaya Knight, Hui-wen Leo, Adrian Ohmer, A Very Quiet Revolution: A Primer on Securities Crowdfunding and Title III of the Jobs Act, Michigan Journal of Private Equity & Venture Capital Law, Vol. 2, p. 135, Fall 2012. See also Joan Heminway, What is a Security in the Crowdfunding Era? 7 Ohio St. Entrepren. Bus. L.J. 335 (2012) University of Tennessee Legal Studies Research Paper No. 204

[83] Preliminary data has already come in showing that securitisation of non-financial firm assets may provide "better" sequestration of individual risks and rewards in a company (as measured by the returns on these securities). Securities which provide investors with better isolation of risks and returns should experience higher demand – and thus higher returns as investors bid up their prices. See Michael Lemmon, Laura Xiaolei Liu, Mike Qinghao Mao, and Greg Nini, *Securitization and Capital Structure in Nonfinancial Firms: An Empirical Investigation*, J. OF FIN. (forthcoming). See also Faten Sabry and Chudozie Okongwu, Study of the Impact of Securitization on Consumers, Investors, Financial Institutions and the Capital Markets, 2009.

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