

Civil Compensation for Misrepresentation of Securities and Countermeasures for Companies

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ABSTRACT

In recent years, the securities market has become more and more active, and the number of false statements in the securities market has increased. In addition, investors' awareness of rights protection has risen, resulting in a growing number of civil compensation cases, and the compensation risks that companies concerned need to bear are rising, which is not conducive to the sound development of companies and the stability of the securities market. This paper will analyze the civil compensation cases of false statements in securities by means of literature analysis, case analysis, and data statistics, and put forward some suggestions for relevant companies to deal with such cases accordingly. The data for this paper mainly comes from CNKI and the website of case judgment. The paper finds that in recent years, firstly, civil compensation cases for securities misrepresentation have increased, and the amount of compensation is also increasing day by day. Secondly, the inclined protection of investors in practical cases is common, and the rights of the company's main body are diminished. Finally, this paper makes three suggestions: for companies, they should do a good job of information disclosure supervision before litigation, and actively respond to litigation after litigation. For directors, the insurance liability system for directors should be established.

Keywords: Securities, false statement, civil compensation, company

1. INTRODUCTION

Nowadays, the securities market has become more and more active, and the number of false statements in the securities market has increased. In addition, investors' awareness of rights protection has risen, resulting in a growing number of civil compensation cases, and the compensation risks that companies concerned need to bear are rising, which is not conducive to the sound development of companies and the stability of the securities market.

Research on civil compensation for securities misrepresentation has made some achievements in today's academic and practical fields, but there is a lack of objective analysis combining data with actual cases. Besides, there are still some disputes about the calculation of the specific amount of civil compensation. Therefore, this paper mainly focuses on cutting in from the perspective of specific data, and combining it with existing cases, putting forward my own views and suggestions on the determination of civil compensation responsibility and the calculation of compensation amount. At the same time, at present, most scholars have

set their sights on perfecting the laws and regulations on civil compensation for securities misrepresentation, but ignoring the identity of the "company" subject in such cases as both "perpetrator" and "victim". Therefore, this paper will also give some suggestions on such cases from the company's point of view. From this, some institutional ideas and opinions on civil compensation for securities misrepresentation are obtained, which can promote the stable development of the securities market, reduce the risk of corporate governance and promote scientific governance.

2. COMPENSATION CASES OF SECURITIES MISREPRESENTATION IN THE MARKET

According to the official case search website, the author sorted out the compensation cases of misrepresentation in the securities market in the past five years (Figure 1). From 2018 to 2021, the civil compensation cases for misrepresentation in China's securities showed a trend of first increasing and then decreasing. By March 2022, there were only seven related cases. Although the upward trend has slowed

down, the number of cases is still high, so we still need to strengthen the discussion of cases in this area.

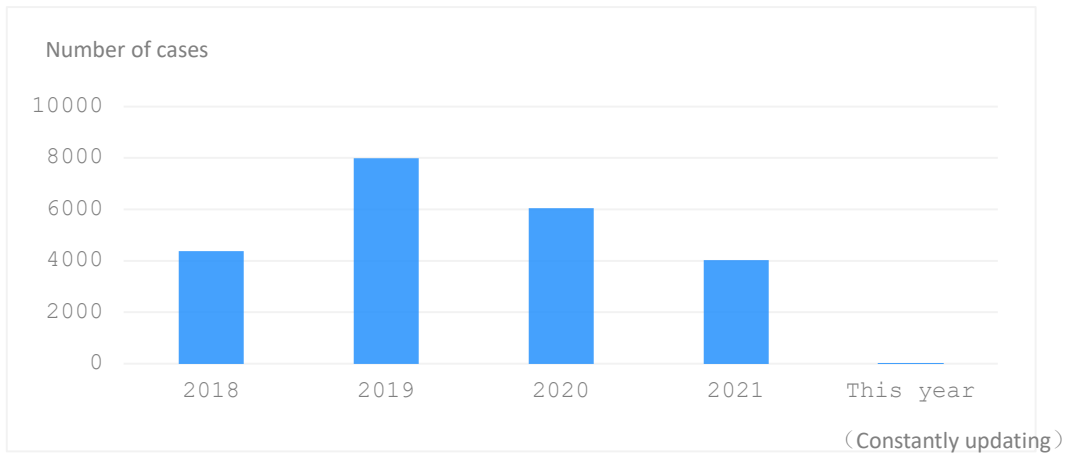


Figure 1 Statistics of civil compensation cases of securities misrepresentation in recent five years (China)

Judging from the target amount of securities misrepresentation cases in the past five years (Figure 2), most of the target amount is between 500,000 and 1,000,000 RMB, and the target amount of case disputes is relatively large, which proves that in recent years. There are many properties involved in misrepresentation

in China's securities market, and if these types of cases cannot be well solved, they are very likely to cause more property disputes, which is not conducive to the interests of the parties involved in the subject property, and it is also easy to cause a series of social problems.

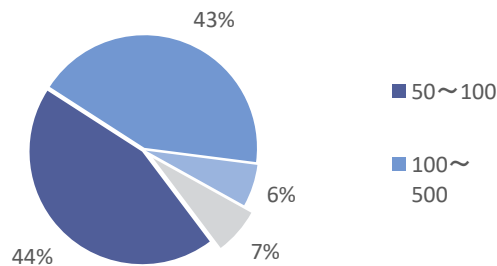


Figure 2 The amount of civil compensation cases of securities misrepresentation in recent five years (China)

3. LEGAL BASIS OF MISREPRESENTATION OF CIVIL COMPENSATION CASES

As far as China is concerned, Article 85 of the Securities Law of the People's Republic of China stipulates that if the information disclosure obligor fails to disclose information according to regulations, or there are false records, misleading statements, or major omissions in the published securities issuance documents, periodic reports, interim reports, or other information disclosure materials, causing investors to suffer losses in securities trading, the information disclosure obligor shall be liable for compensation. The controlling shareholders, actual controllers, directors, supervisors, senior managers, and other directly responsible personnel of the issuer, as well as sponsors, underwriting securities companies, and their directly responsible personnel, shall be jointly and severally liable

with the issuer, except those who can prove that they are not at fault [1].

In the United States, the provisions on securities misrepresentation and corresponding compensation are primarily concentrated in two laws: the Securities Act of 1933 and the Securities Act of 1934. For example, Article 32A of the Securities Exchange Act of 1934 stipulates that any individual or organization who commits fraud or false statements in statutory information disclosure documents will be fined not more than US \$1 million or sentenced to fixed-term imprisonment not more than 10 years, or both. The Sarbanes-Oxley Act of the United States stipulates a maximum of 25 years of imprisonment and a huge fine for securities fraud [2].

4. CONCEPTS RELATED TO CIVIL LIABILITY FOR MISREPRESENTATION

4.1 The Nature of Civil Liability of False Statements

To some extent, the nature of civil liability in the securities market can be regarded as a special kind of civil liability, which can be regarded as civil liability for infringement and civil liability for breach of contract. They blend with each other and are reflected in the civil behavior of securities misrepresentation [3]. However, at present, there is no conclusion about its nature in academic circles. At present, there are some main viewpoints on issues such as breach of contract, distinction, competition and cooperation, infringement, etc. From my personal point of view, I prefer to choose infringement.

4.2 False Statement of Civil Liability Subject

According to the Securities Law of the People's Republic of China and its judicial interpretation, the civil liability subjects of false statements include: issuers and listed companies, internal personnel of issuers or listed companies, sponsors, underwriting securities companies and their directly responsible personnel, institutions or individuals other than issuers or listed companies. Among them, the most important subject is listed companies. For listed companies, they bear strict fault liability. That is, regardless of whether the issuer or the listed company is at fault, they all need to bear civil liability for false statements [3]. In the current responsibility determination of securities misrepresentation cases, emphasis is placed on protecting the rights and interests of injured investors. It is generally believed that listed companies play a key and leading role in investors' investment behavior, have strong subjective intentions, and should bear strict responsibility, which also makes listed companies face greater risks and pressures in such cases.

4.3 The Determination and Form of Civil Liability for False Statements

Regarding false statements, there are provisions on the identification of the responsibilities of each subject in relevant laws. Among them, the issuer (listed company), as the subject of information disclosure, has the motive of making false statements and has carried out false statements in order to successfully obtain financing or other illegitimate interests, which is undoubtedly given the strictest responsibility and bears the main responsibility for false statements [4].

There are two main forms in which the subject of a false statement needs to take responsibility: 1. Contract cancellation. This form of liability is still controversial in

practice. In order to better protect the interests of investors, according to the relevant provisions of contract law, the contract can be revoked to achieve the purpose of withdrawing investment and returning property. 2. Liability for tort damages [5]. This is also the main point of this article. In the case of misrepresentation, investors usually file a lawsuit for infringement with the right to claim damages. The scope of compensation is mainly considered from two aspects: calculation standard and loss share. In practice, according to the general principle of tort compensation in civil law, on the basis of excluding the losses caused by investors' systematic risks in the securities market, the amount of compensation that the company should bear is established, and a scientific loss calculation method is formed.

5. CALCULATION OF CIVIL COMPENSATION AMOUNT FOR MISREPRESENTATION

The amount of compensation for misrepresentation has always been a difficult problem to solve in theory and practice. In the world, there are two main methods to calculate the losses suffered by investors in the securities market due to misrepresentation by actors: the actual loss method and the arithmetic average method [6]. In the process of the development of securities practice, a certain consensus has been formed on the specific calculation standards and rules of the combination of these two methods, which is also helpful in protecting the interests of all parties involved in false statement cases.

5.1 Calculation Method

When false statements appear in the securities market and investors ask for damages, the scope of compensation for companies that make false statements is limited to the actual losses received by investors who make investment choices based on their trust in the false statements. The starting time of compensation is based on the benchmark date, and the investment balance loss is calculated by the difference between the average price of purchased securities and the actual selling price, or the difference between the average price of purchased securities and the closing price of each trading day from the disclosure date of false statements or the correction date to the benchmark date [7]. This method of calculation is more objective. As long as the benchmark date is determined first, the loss of investors can be quickly calculated, and then the compensation that the company should bear can be quickly determined.

5.2 Determination of the Base Date and the Average Buying Price

The key point of the calculation lies in the determination of the benchmark date and the calculation method of the average buying price.

First of all, there are four situations involving the determination of the benchmark date: 1. From the date of disclosure or correction until the total turnover of securities affected by false statements equals 100% of their tradable part. However, the volume of securities transferred through block trade agreements will not be calculated; 2. If it cannot be determined before the court hearing according to the provisions of the preceding paragraph, the 30th trading day after the disclosure date or correction date shall be taken as the benchmark date; 3. If it has already withdrawn from the securities trading market, the trading day before delisting shall be taken as the benchmark date; 4. If securities trading has been stopped, the trading day before the suspension can be taken as the benchmark date.

Secondly, regarding the calculation method of the average buying price, it should be presumed that investors' behaviors in buying securities directly related to false statements from the implementation date of false statements to the disclosure date or correction date are induced by false statements. If investors have multiple buying and selling transactions, the moving weighted average method can be used to determine the average buying price of securities since the first effective purchase, with the average buying price being equal to $(\text{original stock securities cost} + \text{current purchase price} \times \text{current purchase quantity}) \div (\text{original stock securities quantity} + \text{current purchase quantity})$, and the moving weighted average method: the price and quantity of each purchase of securities by investors during the whole period from the implementation date to the disclosure date are considered, and at the same time, the securities for sale are excluded. As far as the calculation convenience is concerned, the moving weighted average method is relatively complicated, but with the progress of technology, the calculation amount problem brought by the moving weighted average method can be solved by analyzing the transaction data and calculating the results by the third-party professional organization using computer software, and it will not increase the difficulty for investors. Using the moving weighted average method to calculate the average selling price of securities conforms to the relevant laws and regulations, and the calculation logic and results are reasonable.

6. THE COMPANY'S RESPONSE SUGGESTIONS

Civil liability for compensation based on misrepresentation is mainly the nature of tort, and the law emphasizes the protection of the interests of the injured investors as the center, taking the damage borne by the injurer as an exception. Therefore, in judicial practice, the capital market should take too much consideration of the interests of investors and fail to pay attention to the reasonable interests of other trading groups [8], especially the corporate entities that are considered to

have the greatest responsibility. Therefore, we need to conceive some measures to reduce the risks and losses caused by civil compensation for companies that are at the center of responsibility in such cases.

First, before the civil compensation lawsuit is filed, do a good job of information disclosure in accordance with the law and compliance, as well as a good job of crisis management. In the actual cases of false statements, there is not only the intentional disclosure of false information for human reasons, but also false statements caused by work negligence. Therefore, while doing a good job in daily management, the company should also focus on checking whether there are any problems in the information disclosure link and strengthening the supervision of the information disclosure link. At the same time, we should also prepare for a rainy day and formulate an emergency plan so that when violations occur, we can respond as quickly as possible and reduce losses.

Second, if the lawsuit has already happened, actively respond to the lawsuit and strive for a favorable judgment. The company actively uses defense points such as "determination of the implementation date of a false statement, determination of disclosure, and judgment of causality" to strive for the most favorable judgment for itself [9].

For company directors, we can try to establish a director's liability insurance system. With the increase of false statement civil compensation cases, the practice risks of directors and other executives also increase, and the compensation risks they bear also increase. Buying insurance for company directors may be a good choice to reduce the directors' risks. Directors and officers' liability insurance ("D&O" for short), which originated in the United States in the 1930s, refers to a kind of insurance that the insurance company pays economic compensation to the underwriting directors, supervisors, and executives when they are held accountable for negligence or misconduct [10]. By spreading the compensation liability of directors in such cases through insurance, the compensation pressure of directors can be reduced, the stability of the company's top management can be maintained, and at the same time, the shock caused by the instability of the company's top management can be reduced, and the company's stability can be maintained.

7. CONCLUSION

In conclusion, the paper finds that in recent years, firstly, civil compensation cases of securities misrepresentation have increased, and the amount of compensation is also increasing day by day. Secondly, the inclined protection of investors in practical cases is common, and the rights of the company's main body are diminished. Finally, this paper gives three suggestions, which two for corporations and another one for directors.

For companies, they should be responsible for information disclosure supervision before litigation, and actively respond to litigation after litigation. For directors, the insurance liability system of directors should be established.

Meanwhile, there are some limitations in the research of securities misrepresentation in this paper. First of all, the research scope is still small, most of research data comes from China, and the data only in recent years. Secondly, the research method is limited to searching the network information, and has not been investigation in practice, which can be studied in the futurer research.

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