The Form of Civil Liability of Securities Service Institutions in Securities Misrepresentation: Reconstruction Based Perspective

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Abstract. In the context of the joint and several liability under Article 163 of the Securities Law of the People's Republic of China, it was common practice to order securities service institutions to assume full joint and several liability without distinguishing the degree of fault and the magnitude of causative potency. Even in the cases of differentiated liability, the court's reasoning on the degree of fault is relatively general and imprecise. Based on China's legislation and trial practice, this research discusses the type of duty of care of securities service institutions. Then it uses case study and comparative research methods to reconstruct the differentiation of liability in misrepresentation, taking into account extra-territorial experience. When the securities service institution commits the misrepresentation intentionally, it shall bear full joint and several liability; if the misrepresentation is caused by gross negligence, it shall bear proportional joint and several liability; if the misrepresentation is committed by general negligence, it shall bear supplementary liability. In this way, reconstructing the joint and several liability restriction in a reasonable way is the proper implementation of consistency of fault and liability.

Keywords: Misrepresentation; joint and several liability; fault; duty of care.

1. Introduction

In order to regulate securities transaction, and for the sake of investors, the doctrine of presumptive is applied to civil cases which involved the tort of misrepresentation in the securities market. According to the Securities Law of the People's Republic of China (hereinafter referred to as the Securities Law), securities service institutions shall be jointly and severally liable to the issuer, which has solidified their duties as "gatekeepers" [1]. However, the stringent provisions on joint and several liability have exposed many enterprises to the risk of enormous compensation, resulting in "deep pockets" for the imputation of securities service institutions [2], which is contrary to the consistency of fault and liability and will impact on the sustainable and sound boost of the socialist market economy.

The Several Provisions of the Supreme People's Court on the Trial of Civil Cases for Damages for the Tort of Misrepresentation in the Securities Market (hereinafter referred to as the judicial interpretations in 2022) further distinguishes intentional torts from negligent torts on the basis of the Securities Law, which contributes to the discretion on the application of joint and several liability to a certain degree. For example, Li A and Zhou A v. Zhonganke Co., Ltd., Investors v. Wuyang Construction Group Co., Ltd., and Chen Yonglin v. Baoqianli Video Technology Group Co., Ltd. all reflect the flexible use of proportional joint and several liability and supplementary liability. However, it is still inconclusive to improve the determination of the civil liability of securities service institutions in accordance with exact jurisprudence.

2. Research Questions

2.1 Current Laws and Regulations

As for the legal system of liability of securities service institutions in misrepresentation disputes (shown in Table 1), not only have these rules varied over time, but there are also subdivisions of rules of different professional institutions. In general, various laws and regulations are not coordinated in liability determination, and the order of application among them is unclear. The Securities Law provides for rigid joint and several liability without distinguishing fault patterns, while the Civil Code and judicial interpretations tend to implement the balance between fault and liability. It is worth noting that the judicial interpretations in 2022 does not make a further distinction of liability, but clearly distinguishes between intent and negligence, which is described as "serious breaches of the duty of care", providing a channel for separate attribution of liability.

Table. 1 The legal system of civil liability of securities service institutions in misrepresentation

Laws and Regulations	**Methods of Liability**
Laws	
Securities Law of the People's Republic of China (2014 Revision)	The doctrine of presumption; joint and several liability. (Article 173)
Securities Law of the People's Republic of China (2019 Revision)	The doctrine of presumption; joint and several liability. (Article 163)
Civil Code of the People's Republic of China	Joint and several liability for acts of joint harm (Article 1168) Joint and several liability for acts of abetting or aiding (Article 1169) Joint and several liability for acts of sufficient cause (Article 1171) Shared liability for acts of non-sufficient cause (Article 1172)
Company Law of the People's Republic of China (2018 Amendment)	The doctrine of presumption; “Shall bear compensation liability within the scope of the inaccurate valuation or verification”. (Article 207)
Law of the People's Republic of China on Certified Public Accountants (2014 Amendment)	“Shall bear compensation liability” (Article 42)
Lawyers Law of the People's Republic of China (2017 Amendment)	“Shall bear compensation liability” (Article 54)
Judicial Interpretations	
Some Provisions of the Supreme People's Court on Trying Cases of Civil Compensation Arising from False Statement in Securities Market (01-09-2003)	“Shall be liable for the portion of its liability” (Article 24) Joint and several liability for intentional acts (Article 27)
Several Provisions of the Supreme People's Court on the Trial of Civil Cases for Damages for the Tort of Misrepresentation in the Securities Market (01-21-2022)	Distinguish between intent and negligence (Article 13 and Article 18)
Several Provisions of the Supreme People's Court on the Trial of Compensation Cases for Civil Tort Involving Accounting Firms Engaging in the Audit Business (06-11-2007)	Joint and several liability for intentional acts (Article 5) “ Its liability shall be determined according to the degree of its negligence.” (Article 6)
Judicial Policy Papers	
Minutes of the National Courts Symposium on the Trial of Bond Disputes (07-15-2000)	Distinguish between intent and negligence (Article 31)
Minutes of the National Courts' Civil and Commercial Trial Work Conference (11-08-2019)	“Liability shall match the tort and the degree of subjective fault.”

When invoking laws and regulations, besides applying the general rules of "new law" and "special law" prevails over "old law" as well as "common law" respectively, a more scientific distinction should be made among the forms of liability in view of the specialty and complexity of the joint torts in securities misrepresentation disputes. Considering the degree of subjective fault, the magnitude of causative potency or other factors, it is rational to give discretion on proportional joint and several liability or supplementary liability.

2.2 Judicial Practices

Before the introduction of the judicial interpretations in 2022, there were several typical cases, such as Li A and Zhou A v. Zhonganke Co., Ltd. and Investors v. Wuyang Construction Group Co., Ltd., which broke the routine of full joint and several liability and creatively established the adjudication of proportional joint and several liability. In contrast, Chen Yonglin v. Baoqianli Video Technology Group Co., Ltd. is applied to the supplementary liability.

Nevertheless, the criteria for the degree of fault are still inconsistent in the specific field of trial. The duty of care is an objective expression of subjective fault, but current laws and regulations do not unify the determination criteria for the duty of care. The relevant criteria are scattered in some regulations, such as the Measures for the Administration of the Provision of Securities Legal Services by Law Firms and the Auditing Standards for Certified Public Accountants of China. In practice, however, the liabilities of securities service institutions are highly overlapping. And the issue documents are heavily cross-referenced and mutually guaranteed. These problems increase the difficulty of clear accountability and lead to the tendency of consequentialism in the trial. Therefore, the duty of care shall be determined by different factors, such as the impact of misrepresentation on investors' decision-making, the degree and stage of participation of the perpetrator, and the area of expertise and responsibility. However, judges have usually expressed in general terms that the institutions failed to exercise the most basic, necessary or appropriate care without clearly distinguishing the specific types of breach of the duty of care.

In Investors v. Wuyang Construction Group Co., Ltd., although Zhejiang Provincial Higher People's Court held that the law firm only had a general duty of care concerning financial data, it should have paid special attention to matters such as significant debt obligations and major asset changes that might involve the terms of the bond issue and solvency. The law firm was ultimately held jointly and severally liable for the failure to disclose the sale of the investment property, but it was not identified whether the lawyer should have represented the information and whether it had received unusual signals about the transaction. Similar to Li A and Zhou A v. Zhonganke Co., Ltd., Shanghai High People's Court decided that the law firm was not liable for the inaccuracy of the appraisal value of the restructuring object and could reasonably rely on the professional opinion of the appraisal agency without being responsible for the accuracy, authenticity and completeness of the appraisal content. The divergent judgments in the same case indicate the incompatibility of judicial authorities on the standard of duty of care.

In conclusion, applying non-rigid liability such as proportional joint and several liability or supplementary liability can effectively coordinate the differences between the Securities Law and other regulations, which is conducive to balancing the legal rights of all parties and keeping an open, fair and equitable securities market orderly.

3. The Boundary of Responsibilities and the Scope of Liability of Securities Services

In order to clarify the responsibilities of different securities service institutions in securities issuance, it is essential to reasonably evaluate which functions securities service institutions can serve in specific scenarios and the effect of actions on the transaction and loss of investors so as to avoid expanding the scope of liability and imposing overly strict liability on them for any securities fraud.

In practice, when judging the responsibilities and the scope of liability of securities service institutions, the following dimensions can be considered:

3.1 Type of Security

The types of security issuance can be divided into stock issuance and bond issuance in accordance with the difference in sources of the asset. On the one hand, there are several dissimilarities between the two types of security, such as investment risk, transaction causation, and loss causation [3]. On the other hand, the judicial interpretations in 2022 are too general to define the parameters of the duty of care of relevant securities service institutions and establish the benchmark of the due diligence defense. It is, therefore, necessary to further distinguish and improve the boundary of responsibilities of securities service by comparing the divergences between the stock market and the bond market. Two aspects are taken as examples: (1) In terms of investment purpose and investment risk, bond transaction mainly involves credit risk, and securities service institutions mainly focus on the investigation of the issuer's willingness and solvency, whereas stock transaction risks mainly come from the operational risks of the listed company, and securities service institutions pay more attention to the company's business management, finance. (2) With regard to investor type, there is also a disparity between significant investors in the two markets in their ability to obtain and process information [4]. Most investors in the bond market are expert agency investors who have a deep understanding of the issuer's credit status. Consequently, securities service institutions have a lower obligation to investigate the subject qualification of the issuer, while individual investors dominate the stock market with minimal access to all kinds of valid information about the listed companies. Namely, securities service institutions have a higher duty to examine subject qualifications.

3.2 Role of Security Services

Under Article 18 of the judicial interpretations in 2022, the responsibilities of securities service institutions shall be limited to their scope of work and areas of expertise. That is, securities service institutions have a special duty of care for their work and professional fields. If securities service institutions have partially overlapping responsibilities, they should adhere to the division of duties with professionalism as the core in practice. The typical securities service institutions in the securities market include accounting firms, law firms, asset appraisal services, and credit rating institutions. Accounting firms are responsible for implementing audit procedures and risk assessments on the financial situations of the business involved and matters that significantly impact financial statements [5]. Law firms are mainly focused on law-related issues in securities issuance and listing. Asset securities service institutions are in charge of evaluating and estimating real estate, movable property, intangible assets, and other economic rights and interests. Credit rating institutions are entrusted with the research and analysis of the factors correlative with the credit risks of the assessed object, especially solvency and willingness.

3.3 Stage of Issuance

Various securities service institutions have different degrees of participation during the securities issuance process. In the IPO market, the sponsor undertakes the responsibility of comprehensive guidance, supervision, and review under the pattern of the lead sponsor. During securities, the services and management of lead underwriters should keep continuous, while accounting firms, law firms, and asset appraisal services only perform their respective functions at certain stages. However, credit rating agencies shall earnestly fulfill the obligation of tracking and rating, regularly assessing risks, and issuing rating reports. In addition, in disclosing periodic reports, accounting firms need to audit the regular reports of listed companies to carry out the duty of disclosure as required.

3.4 American Experience: Sliding Scale of Liability

Based on the premise of "reasonable investigation" and "reasonable reliance", U.S. case law developed the "sliding scale of liability" standards, which is worthy enough to borrow. Due to the general scope of information availability and professional ability to determine the due diligence of intermediaries, the duty of care requires tailor-made and case-by-case discussions [6]. The Securities and Exchange Commission (SEC), through Rule 176, outlines several factors that affect the due diligence standard, including but not limited to: (1) The type of business of the issuer and the public interest in which the defendant is expected to protect for the reason of position: The more important the public interest, the more detailed the investigation should be. For startups or high-tech companies, securities service institutions should investigate in detail. The banking industry survey should contain more information than the general industry. (2) Status, position, and importance of relevant responsible subjects: As for the verification obligation, the subject of primary responsibilities is higher than other subjects, and inside directors are higher than outside directors. (3) The type of security being sold: It is concerned with assessing the financial position and prospects of the issuer. (4) Whether the defendant is dependent on others [7].

Additionally, the "sliding scale of liability" emphasizes the rationality of securities service institutions' actions or omissions in specific situations: even if there is a gap from the ideal standard, securities service institutions do not need to bear civil liability. That is to say, the judgment should focus on the fault of securities service institutions in examining the due diligence process rather than directly inferring liability from the results.

4. Refinement of the Approaches

4.1 Typology of the Duty of Care

The duty of care is the core element in determining whether a party is negligent. Drawing on the "sliding scale of liability" of U.S. law, the attribution of due diligence to securities service institutions can be achieved by the objectification as well as typification of the standard of duty of care, so as to strike a balance between investor protection and financing efficiency. In a scenario for negligence, the degree of negligence of a securities service institution can be examined in two dimensions: (1) the type of duty of care: whether it is a special or general duty of care; and (2) the degree of performance of the duty of care: whether it is not performed at all or incompletely performed.

4.1.1 The Distinction Between the "Special Duty of Care" and the "General Duty of Care

The notice by the Supreme People's Court on Issuing the Minutes of the National Courts Symposium on the Trial of Bond Disputes made it clear that securities service institutions are subject to a duty of special care concerning business matters relating to their respective professions and a general duty of care regarding other business matters.

However, there is not one definitive explanation in the relevant regulatory documents as to what is a "special duty of care" and a "general duty of care." The difference between the two is based on the difference in the reference system [8]. The former refers to members of the professional group, which suggests that the party should fulfill the duty of care as experts in the professional field. In contrast, the latter refers to the general public, which indicates that the party should perform the general care of obligation as ordinary people [9].

To avoid unduly increasing the standard of the duty of care and legal risks for securities service institutions and relevant practitioners, the special duty of care shall further refer to the average level of care of the professional members. Meanwhile, seeing that playing a crucial role in reducing information asymmetries in the securities market, securities service institutions should provide more reasonable assurance to investors [10]. Even if the general duty of care is to the community, it should still be slightly higher than the medium level of care for the public.

4.1.2 Degree of Fulfillment of Duty of Care

(1) Criteria for Determining the Degree of Fulfillment of Duty of Care

Different matters and professional areas will lead to varying duties of care, which will directly make a difference in the judgment on the performance of the duty of care [11]. Thus, it is of great necessity to refine the standard of duty of care to a certain extent in order to avoid not only overly aggravating the duty of care and legal risks of the securities service institutions but also making the duty of care become a “pocket element” of fault determination [12].

The extent to which a securities service institution has fulfilled its duty of care should be judged by a combination of subjective and objective criteria based on the specific performance of its duties. The subjective standard for the duty of special care is whether the securities service institution has exercised professional care, eliminated professional doubts, made a professional judgment, and obtained reasonable assurance. Subject to the judicial interpretations in 2022, the objective standard for the duty of special care is whether the securities service institutions' functional conduct complies with laws, regulations, departmental rules, and other normative documents.

However, according to the relevant provisions of the judicial interpretations in 2022, securities service institutions, in fulfilling their general duty of care, are required to conduct "prudent checks, necessary investigations and reviews" of opinions not in their area of expertise. Thus, reasonable reliance on other securities service institutions can be established to be exempted from liability. The "reasonable reliance condition" establishment prevents securities service institutions from performing a superficial duty of formal review as the general duty of care.

(2) Degree of Performance of Duty of Care and Degree of Negligence

In the circumstance of negligence, the rules for determining the degree of negligence need to be clarified. The extent of the securities service institution's negligence shall be judged in light of the type of duty of care owed by the securities service institutions and the actual degree of performance.

Table. 2 The combination of the degree of performance of the duty of care and the degree of negligence

	Duty of special care	General Duty of Care
Gross negligence	Severe breaches of the duty of special care: Complete failure to comply with verification procedures in expertise;	Complete failure of the review process for the general duty of care.
General negligence	Failure to fully comply with verification procedures in expertise	Not fully carry out review procedures of the general duty of care.

4.2 The Path to Determining the Form of Liability

Usually, even if the issuers are held strictly liable for their misconduct, the securities service institutions will face the liability by the presumption of fault under the Securities Law rather than the same strict liability as them [13]. Statutory joint and several liability have a two-sided effect on regulating the persistent securities market disclosure problem. Joint and several liability encourage plaintiffs to seek total compensation from the parties with the “deepest pockets” [2] rather than from the parties that contributed the most major causation to the damage, leading to the risks being transferred by the genuinely responsible party. To implement the “gatekeeper” role of securities service institutions, the authors suggest that the degree of duty of care of different securities service institutions in misrepresentation and other indicators should be examined to determine their degree of fault and causative potency prudently, distinguish the form and proportion of liability and adopt a trichotomy of "full joint and several liability + proportional joint and several liability + supplementary liability", which is assumed as a suitable and efficient mechanism for differentiating liability.

4.2.1 Where the securities service institution is intentional, it shall bear full joint and several liability.

It is hardly controversial in theory and practice that a securities service institution and an issuer have a joint intent to misrepresent and are fully jointly and severally liable.

4.2.2 Where the securities service institution is gross negligence, it shall be responsible for proportional joint and several liability.

The judiciary in China has creatively applied proportional joint and several liability to punish the misrepresentation of securities service institutions, which has achieved the effect of corrective justice.

From the perspective of semantic interpretation, the concept of "joint and several liability" is not given a detailed definition in the Securities Law. Namely, it is unclear that "joint and several liability" only refers to "full joint and several liability ". This leaves room for applying "proportional joint and several liability."

From the perspective of systematic interpretation, the development of "proportional joint and several liability" is not without a source. As in the legal logic of the court in Li A and Zhou A v. Zhonganke Co., Ltd., going back to the Securities Law of 1998, the expression "jointly and severally liable for the part for which it is liable" existed in the rules at that time. In addition, by reference to the fault under the Securities Law, the judicial interpretations in 2022 distinguish between "intentional" and "negligent" cases, which is to break the "rigid joint and several liability" in the case of negligence. The distinction between "intentional" and "negligent" cases also leaves room for discretion. If the court imposes absolute joint and several liability regardless of the fault, it will breach the purpose of the new regulation.

From the perspective of teleological interpretation, "Proportional joint and several liability put high pressure on securities service institutions within a fair and reasonable scope, as well as protect the interests of investors to the fullest extent. What's more, it can serve as a corrective justice to avoid overburdening the securities service institutions and to balance the interests of investors and securities service institutions [14].

4.2.3 Where the securities service institution is generally negligent, it is subject to supplementary liability.

Compared to the case of gross negligence, the imputation of liability to those responsible for general negligence should be moderated. In Chen Yonglin v. Baoqianli Video Technology Group Co., Ltd., the court found that Yinxin failed to exercise due diligence in the evaluation process, which resulted in the occurrence or expansion of losses that could have been avoided or reduced, and that it was a supplementary liability party within a 30% range. The supplementary liability regime is further mitigation of the joint and several liability models, emphasizing the subordination of multiple liable parties in joint liability and reflecting the different nature and degree of fault between multiple liable parties. The supplementary liability of the securities service institution in case of ordinary negligence is in line with the consistency of fault and liability.

5. Conclusion

Starting from the point of the subjective fault of securities misrepresentation, the authors propose that the legislative institution and the judicial organ shall typify the forms of civil liability of securities service institutions according to the degree of fault in causing losses to investors. On the basis of clarifying the joint and several liability stipulated in the existing legal system, it is helpful to form more scientific, comprehensive, and unified adjustment standards, reduce the legal disputes between different levels of laws and regulations in judicial practice, and implement the principle of "consistency of fault and liability".

A new urgency has taken due to the issue of trust in the securities market, but the securities market cannot operate if there is a lack of trust [15]. Optimization of determining the liability pattern of securities service institutions is conducive to promoting the peaceful and long-term healthy development of both securities service institutions and the securities market. In addition, this improvement path contributes to maintaining the integrity of the capital market, enhancing investors' confidence in the securities trading market, balancing the interests of investors and securities service institutions, and thus promoting the smooth operation of the national economy.

At the same time, since Li A and Zhou A v. Zhonganke Co., Ltd., the causative potency has become one of the major factors for securities service institutions to defend. The causative potency has also been introduced into the judicial decisions to clarify the form and scope of liability. Therefore, it is not appropriate for the degree of fault of the securities service institutions to be the only element for the regulation in the proportion calculation. In the future, it is recommended that further in-depth researches focus on the study of causative potency of securities service institutions on the misrepresentation , especially considering the stage of participation, the degree of participation, and the scope of responsibilities.

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