

Accounting for the Unaccountable: Does the Holding Foreign Companies Accountable Act deter Chinese Companies?

Grant Newman

ABSTRACT

The Holding Foreign Companies Accountable Act (“HFCAA” or “the Act”) threatens to prohibit trading in Chinese companies listed in the United States if the Public Certified Accounting Board (“PCAOB”) is unable to oversee their respective Chinese auditors. By assessing the limits of protection the HFCAA offers U.S. investors, this Note argues that the statute’s more fundamental objective is to deter Chinese companies from listing in the United States. Hence, this Note asks whether the HFCAA deters or will deter Chinese companies from listing or remaining listed in the United States. To answer this, this Note examines data collected by the Author on China-based¹ company listings to determine the percentage of China-based company listings on U.S. exchanges over Chinese domestic listings from 2010 to 2023. The results indicate that a higher proportion of Chinese firms have opted to list their stocks domestically since the HFCAA’s passage.² Accordingly, the HFCAA has the consequence of benefitting Chinese and Hong Kong exchanges while incentivizing Chinese regulators to increase their control over Chinese companies’ listing destinations. Given recent developments, such as the PCAOB receiving full access to inspect Chinese auditors,³ an evaluation

1. Hong-Kong based companies were included as China-based given the deterioration of Hong Kong’s self-governing status and that Hong Kong and China both prevented PCAOB inspections. *See infra* note 72; *see also infra* note 121.

2. *See infra* Chart B.

3. *See* Erica Y. Williams, *PCAOB Secures Complete Access to Inspect, Investigate Chinese Firms for the First Time in History*, PCAOB (Dec. 15, 2022), <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-secures-complete-access-to-inspect-investigate-chinese-firms-for-first-time-in-history>. Many scholars and commentators were doubtful the PCAOB would ever be granted full access. *See, e.g.*, Tamar Groszold Ozery, *Illiberal Governance and the Rise of China’s Public Firms: An Oxymoron or China’s Greatest Triumph?*, 42 U. PA. J. INT’L L.

of the deterrent force of the HFCAA is both timely and provides insight into the ramifications of the HFCAA that will be of interest for U.S. investors and policymakers.

INTRODUCTION

For the better part of the past two decades, China has strategically reduced its “dependence on foreign technology and capabilities,” signifying a strategic shift “from economic growth to economic control.”⁴ Correspondingly, the United States has more recently garnered rare bipartisan support for economic decoupling in the name of national security between the United States and China.⁵ One such measure, the Holding Foreign Companies Accountable Act, imposes a trading ban on all U.S.-listed Chinese securities if the PCAOB is unable to oversee their respective Chinese auditors.⁶

Passed shortly after the Luckin Coffee Fraud,⁷ the HFCAA is ostensibly motivated by Congresses’ desire to protect U.S. investors.⁸ U.S. investors have long been stymied by *both* a legal regime for FPIs (“FPIs”) that offers inadequate protection when applied to U.S.-listed Chinese companies⁹ *and* by barriers to enforcing that legal regime against Chinese insiders.¹⁰ The HFCAA attempts to rectify Chinese non-compliance in one aspect of this legal regime—that is, PCAOB inspections of U.S.-listed auditors working for Chinese companies’ auditors. PCAOB inspections help ensure accurate and reliable financial reporting.¹¹ This is essential not only to the accurate

921, 994 (2021).

4. J. Stewart Black & Allen J. Morrison, *The Strategic Challenges of Decoupling*, HARV. BUS. REV. (May-June 2021), <https://hbr.org/2021/05/the-strategic-challenges-of-decoupling>.

5. See Jon Bateman, U.S.-China Technological “Decoupling”: A Strategic and Policy Framework, CARNEGIE ENDOWMENT FOR INT’L PEACE (Apr. 25, 2022), <https://carnegieendowment.org/2022/04/25/u.s.-china-technological-decoupling-strategy-and-policy-framework-pub-86897>.

6. See S. 945, 116th Cong. (2020), <https://www.congress.gov/bill/116th-congress/senate-bill/945/text>.

7. See *infra* Section II.A.

8. Van Hollen, *Kennedy Introduce Holding Foreign Companies Accountable Act as NDAA Amendment*, CHRIS VAN HOLLEN U.S. SEN. FOR MD. (June 25, 2020), <https://www.vanhollen.senate.gov/news/press-releases/van-hollen-kennedy-introduce-holding-foreign-companies-accountable-act-as-ndaa-amendment>.

9. See *infra* Section I.D.

10. See *infra* Sections I.C, I.E.

11. Robin Hui Huang, *The US-China Audit Oversight Dispute: Causes, Solutions, and Implications for Hong Kong*, 54 THE INT’L LAW. 151, 156 (2021).

assessment of a company's value,¹² but also to verify the quality of disclosure.¹³ Yet, the act fails to couple this with additional disclosure requirements that meaningfully address problems U.S. investors face.¹⁴

Granted, the crux of the underlying problem U.S. investors in Chinese companies face—barriers to enforcement against Chinese insiders and their assets— have fleeting solutions that are unlikely to ever be fully rectified.¹⁵ Still, other problems have more ascertainable solutions that were disregarded by the HFCAA.¹⁶ For example, even with PCAOB inspections, Chinese insiders can still trade on non-public information to avoid losses with virtual impunity.¹⁷ This is due in large part to enforcement issues, but also because it is difficult to even detect insider trading violations by Chinese insiders as FPIs are exempt from many significant disclosure requirements that apply to Domestic Issuers.¹⁸ By abandoning certain aspects of the FPI disclosure regime for Chinese issuers, such as imposing Form 4 electronic short swing trading requirements on Chinese issuers, Chinese insiders would, *at the very least*, be less likely to bypass public scrutiny for their ever-so-conveniently timed trades.¹⁹ Yet, the HFCAA does not impose any such disclosure requirements that would directly benefit U.S. investors.

Instead, the HFCAA is sodden with disclosure requirements attempting to identify Chinese government influence over Chinese firms that provide negligible functional utility to U.S. investors.²⁰ Rather than protect U.S. investors, the HFCAA disclosure requirements are oriented towards national security and foreign policy objectives. Specifically, these disclosures are likely to aid in identifying a growing blacklist of Chinese Military Companies.²¹ In effect, this contributes to providing grounds to prohibit trading of any given Chinese company outside of the HFCAA.²² Moreover, the HFCAA forces PCAOB inspection compliance not by imposing monetary

12. See, e.g., *infra* Section II.A.

13. See *AS 2501: Auditing Accounting Estimates, Including Fair Value Measurements*, PCAOB, <https://pcaobus.org/oversight/standards/auditing-standards/details/AS2501> (last visited Apr. 11, 2023).

14. See *infra* Section II.D.

15. See generally *infra* Section I.C.

16. See *infra* Section I.D.

17. See *id.*

18. See *id.*

19. See *id.*

20. See generally *infra* Section II.D.

21. See *id.*

22. *Id.*

penalties, but instead, by delisting Chinese issuers who do not comply with PCAOB inspections for three consecutive years. This most clearly affects Chinese State-Owned Enterprises (“SOEs”), which must prioritize shielding state secrets from American regulators over remaining listed in the United States.²³ However, the line between state-owned enterprise and privately-owned enterprise is blurred for Chinese companies.²⁴ As a result, *all* Chinese issuers are at risk of being delisted.

At the same time, China may even embrace U.S. delistings as they are eager to host the most prominent Chinese companies on Chinese exchanges.²⁵ China has implemented reforms to Chinese domestic exchanges designed to alleviate problems which forced many Chinese companies to seek an overseas listing.²⁶ In addition, Chinese regulators have exerted increasing control over private Chinese companies’ listing destinations since the passage of the HFCAA.²⁷ In light of the Chinese response to the Act, this note assesses the effectiveness of the HFCAA in protecting U.S. investors and seeks to evaluate the extent to which the Act deters Chinese companies.

Part I of this note will provide background regarding the types of Chinese firms listed in the United States and the reason for listing. This Part also displays the risks posed to U.S. investors in U.S.-listed Chinese firms by highlighting barriers to enforcement, the disclosure regime applicable to Chinese-Issuers, and the lack of audit oversight. Part II analyzes the provisions of the HFCAA and evaluates their limitations in light of the corresponding Chinese regulatory response. Part III examines the extent to which Chinese Firms have thus been deterred from listing in the United States using data and ensuing changes from the European, Hong Kong, and Chinese Stock Exchanges.

23. *See infra* notes 207–10. Chinese officials have frequently cited the protection of state secrets as the proffered reason for blocking PCAOB inspections. *See* Hui Huang, *supra* note 11, at 163 (noting in a 2009 policy statement, the Chinese State council published plans for the accounting industry which explicitly asked companies that are listed in foreign markets, especially SOEs, to preferentially choose those accounting firms that are beneficial “to protecting the safety of national economic information”). *Id.*

24. *See generally infra* Section II.D.

25. *See generally infra* Section III.C.

26. *Id.*

27. *See generally infra* Section II.C.

I. BACKGROUND

A. A TYPOLOGY OF CHINESE LISTINGS IN THE UNITED STATES

China-based firms that have listed in the United States can be broken down into three categories: SOEs, Private-sector reverse-merger firms, and Technology firms that typically conduct an Initial Public Offering (“IPO”) using a variable interest entity (“VIE”).²⁸

Chinese companies first began listing in the United States in the 1990s as the Chinese government encouraged its largest enterprises to tap foreign capital and benefit from the enhanced governance standards of U.S. exchanges.²⁹ Larger SOEs dominated the bulk of China-based U.S. listings until the 2000s, which saw a tidal wave of smaller, privately-owned companies list.³⁰ Over 150 of these firms listed through a reverse-merger, whereby they listed only in the United States, typically by merging with a public shell company in Delaware or Nevada.³¹ By doing so, the firms were able to raise U.S. capital while bypassing scrutiny from the U.S. Securities and Exchange Commission (“SEC”) regarding its disclosures.³² Many fraudulent firms were eventually exposed, resulting in numerous China-based firms being delisted or forced to stop trading due to violations of U.S. securities law.³³

Chinese technology companies—from Baidu in 2005 to Alibaba’s record IPO in 2014—typically list in the U.S. using a VIE.³⁴ A variable

28. Jesse M. Fried & Ehud Kamar, *China and the Rise of Law-Proof Insiders* 6–7 (Eur. Corp. Governance Inst., Working Paper, Paper No. 557, 2022); Paul L. Gillis, *Testimony before the U.S.-China Sec. and Econ. Comm’n* 33–35 (Feb. 28, 2019).

29. See Qu Feng et al., *A Narrative on Overseas Listing by Chinese Firms*, 3–4 (Oct. 12, 2022), https://personal.ntu.edu.sg/guiying.wu/narrative_overseas_listing.pdf; see also U.S.-CHINA ECON. & SEC. REV. COMM’N, 113TH CONGRESS, 2013 REPORT TO CONGRESS 9 (2013) https://www.uscc.gov/sites/default/files/annual_reports/Complete%202013%20Annual%20Report.PDF; see generally, Shigeo Kobayashi et al., *The “Three Reforms” in China: Progress and Outlook*, JAPANESE RSCH. INST. (Sept. 1999), <https://www.jri.co.jp/english/periodical/rim/1999/RIME199904threereforms/> (explaining the landscape of reforms to Chinese SOEs beginning in 1978 through the 1990s).

30. See James S. Ang et al., *Good Apples, Bad Apples: Sorting Among Chinese Companies Traded in the US*, 134 J. BUS. ETHICS 611, 612 (2014) (“The number of US-listed Chinese companies grew from 34 to 294 from 2001 to 2011.”).

31. Fried & Kamar, *supra* note 28, at 22.

32. *Id.*

33. *Id.* at 23.

34. For an overview of variable interest entities, see *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INSTITUTIONAL INVESTORS (Dec. 2017), https://www.cii.org/files/publications/misc/12_07_17%20Chinese%20Companies

interest entity consists of contractual arrangements between a holding company domiciled in the Caribbean and a Chinese operating company.³⁵ This allows Chinese companies to list in the United States while circumventing Chinese restrictions on foreign investment.³⁶ Today, over 68% of Chinese companies listed in the U.S. use a VIE structure.³⁷ Notably, while some China-based U.S.-listed technology companies cross-list in Hong Kong, not one of these firms list concurrently in China.³⁸

For many Chinese companies, especially young high growth technology companies, listing abroad is driven by access to capital as they cannot list in the Chinese A-share market.³⁹ Although reforms for a registration-based system are underway,⁴⁰ China has traditionally subjected domestic listing applicants to a long winded merit based application and approval process conducted by the government.⁴¹ Unlike listing requirements of U.S. exchanges, a firm must have positive net income prior to filing for IPO on Chinese exchanges.⁴² Because firms are unable to meet these standards at the time of listing, they look to file their IPOs in the U.S. instead. In fact, 144 of the 321 Chinese IPOs listed on major U.S. exchanges from 1992–2021 were unprofitable at the time of the IPO.⁴³ In addition to the long IPO wait

%20and%20the%20VIE%20Structure.pdf [hereinafter *Buyer Beware*].

35. See *Sample Letter to China-Based Companies*, U.S. SEC. & EXCH. COMM'N (last modified Dec. 20, 2021), <https://www.sec.gov/corpfm/sample-letter-china-based-companies#.ftn2>.

36. See *Buyer Beware*, *supra* note 34, at 7.

37. See U.S.-CHINA ECON. & SEC. REV. COMM'N, CHINESE COMPANIES LISTED ON MAJOR U.S. STOCK EXCHANGES 8 (Jan. 9, 2023), https://www.uscc.gov/sites/default/files/2023-01/Chinese_Companies_Listed_on_US_Stock_Exchanges_01_2023.pdf (“184 Chinese companies listed on the three major U.S. stock exchanges use a VIE.”).

38. See Fried & Kamar, *supra* note 28, at 7. *But see infra* Section III.B.

39. A-shares refer to securities of companies incorporated in China that trade on either the Shanghai or Shenzhen Stock Exchange and are denominated in Chinese renminbi. See DANLING YU, CHINESE BUSINESS LAW 80 (Dayuan Han ed., 2019). Songhui Li, *The Recommendations for Chinese Companies Projecting to Listing Overseas*, 62 ADVANCES IN ECON., BUS. & MGMT. RSCH. 417, 417–19 (2022) (arguing that the reason why many Chinese companies chose to list overseas is because they cannot fulfill IPO requirements in China and rather seek to acquire a premium); see Grosword Ozery, *supra* note 3, at 928.

40. See *infra* Section III.C.

41. See Grosword Ozery, *supra* note 3, at 929; see YU, *supra* note 39, at 99–100.

42. The Shanghai Stock Exchange requires firms to have positive income in each of the last three years prior to IPO, where the Growth Enterprise Market Board enables companies with positive income for only the prior year to file for an IPO. Yiming Qian et al., *Initial Public Offering Chinese Style*, 59 J. OF FIN. AND QUANTITATIVE ANALYSIS 1, 9 (Aug. 2022) <https://ssrn.com/abstract=3682089>.

43. *Id.* at 31.

times and profitability requirements, Chinese foreign investment restrictions make a U.S. listing more conducive to the exit strategy of U.S. venture capital, which has plowed billions into many high growth Chinese technology companies before an IPO.⁴⁴ This makes it relatively easier for young companies to tap U.S. capital markets.⁴⁵

B. I.B REASONS FOR LISTING OVERSEAS.

Beyond the reasons specifically applicable to Chinese companies, academic literature posits companies list overseas because they acquire a premium. The predominant explanations for this premium have been explained by the market segmentation hypothesis and the bonding hypothesis. The market segmentation hypothesis dictates that companies overcome investment barriers by listing overseas to access trapped pools of liquidity and obtain a lower cost of capital.⁴⁶

Although China's capital markets have grown to be the second largest in the world "[i]n less than three decades,"⁴⁷ the U.S. stock market is still far more conducive to liquidity.⁴⁸ This is in part because Chinese firms tend to have higher levels of "non-tradable state ownership."⁴⁹ Unlike the United States, the Chinese stock market is still dominated by retail investors, which leads to more irregular trading activity.⁵⁰ To the dismay of institutional investors, Chinese

44. See Adam Lysenko et al., *Disruption: U.S.-China Venture Capital in an Era of Strategic Competition*, RHODIUM GRP (Jan. 2020), https://publications-research.s3-us-west-2.amazonaws.com/RHG_Disruption_US+China+VC_January2020.pdf; cf. Cheng Cheng & Armin Schwienbacher, *Venture Capital Investors and Foreign Listings of Chinese Companies*, 29 EMERGING MKTS REV. 42 (2016) (finding that Chinese companies backed by Chinese domestic VCs are significantly less likely to list abroad). U.S. venture capital investments in Chinese companies has been shrinking from a peak of \$20 billion in 2018. Thilo Hanenmann et al., *Two-Way Street: 2021 Update US-China Investment Trends*, RHODIUM GRP. (May 2021), https://rhg.com/wp-content/uploads/2021/05/RHG_TWS-2021_Full-Report_Final.pdf.

45. Fried & Kamar, *supra* note 28, at 7.

46. John C. Coffee Jr., *Racing Towards the Top?: The Impact of Cross-listing and Stock Market Competition on International Corporate Governance* 102 COLUM. L. REV. 1757, 1767 (2002); Amir Licht, *Regulatory Arbitrage for Real: Intentional Securities Regulations in a World of Interacting Securities Markets*, 38 VA. J. INT'L L. 563, 569 (1998).

47. Grosword Ozery, *supra* note 3, at 927.

48. See Rui Ma, Hamish D. Anderson, Ben R. Marshall, *Stock market liquidity and trading activity: Is China Different?*, 56 INT. REV. FIN. ANALYSIS 32, 32-33 (2018) (highlighting the differences between the U.S. market and China that contribute to liquidity issues).

49. *Id.* at 32.

50. *Id.* at 33. More unsophisticated investors tend to "hold loser stocks longer than winner stocks." *Id.* Trading activity in China increases more in up markets than in down markets, whereas trading activity reacts symmetrically in up and down markets

regulators frequently exercise authority to suspend trading for relatively long durations amid market volatility.⁵¹ As a result, Chinese firms are likely to list on a U.S. exchange in part to access pools of liquidity.

More significantly, the bonding hypothesis⁵² postulates that companies are paid a premium when they list overseas because companies lower their cost of capital when they voluntarily choose to “bond” themselves to heightened standards.⁵³ The premium is reflected by a higher share price as the promise to abide by these heightened standards signals legitimacy, a commitment to improve corporate governance, and a promise to protect minority shareholders. These heightened standards come principally through increased disclosure and stricter enforcement of laws.⁵⁴ From an extra-legal perspective, firms that list in the U.S. commit themselves to reputational scrutiny by groups such as U.S. underwriters, security analysts, and the financial media.⁵⁵

However, using the bonding theory to explain why companies list overseas may underestimate the potential for insider opportunism because it inherently links the interest of issuers with those of insiders in decision-making positions,⁵⁶ yet the interest of insiders and the corporation do not always align in practice. Regardless of the

in the United States. *Id.*

51. Eddie Pong, *The Suspension World of the China A-Shares Market*, RIVERMAP QUANT. RSRCH. (May 29, 2018); Shen Hong & Stella Yifan Xie, *That Calm Chinese Stock Market? It's Engineered by the State*, WALL ST. J. (May 31, 2018), <https://www.wsj.com/articles/that-calm-chinese-stock-market-its-engineered-by-the-government-1527775089>.

52. The bonding hypothesis is derived from Jensen and Meckling's widely cited *Theory of the Firm*, which deduces that owner-managers will bear agency costs and voluntarily bond themselves and accept monitoring measures in order to sell companies at a higher price. Michael C. Jensen & William H. Meckling, *Theory of the Firm; Management Behavior, Agency Costs, and Ownership Structure*, 3 J. FIN. ECON. 305 (1976).

53. Joel Malen, Paul M. Vaaler, & Ivy Zhang, *Legal Leapfrogging? Legal System and Rule of Law Effects on Cross-Listing to Bond by Emerging-Market Firms*, (Working Paper, May 26, 2022) (demonstrating the bonding effect tends to be stronger among emerging market firms where the home-country legal protection is weaker, the firm comes from a civil law legal system, and individual firm growth opportunities are greater).

54. See Coffee, *supra* note 46, at 1780–82.

55. *Id.* at 1781–82; see also Yuliya Guseva, *Extraterritoriality of Securities Law Redux; Litigation Five Years after Morrison v. National Australian Bank*, 2017 COLUM. BUS. L. REV. 199, 223–26. For additional bonding factors, see Hua Cai, *Bonding, Law Enforcement and Corporate Governance in China*, 13 STAN. J.L. BUS. & FIN. 82, 92–108 (2007).

56. See Amir N. Licht, *Cross-Listing and Corporate Governance: Bonding or Avoiding?*, 4 CHI. J. INT'L L., 141, 142 (2003).

alignment of interests, it is reasonable to expect insiders “to actively seek their own benefit” when choosing a legal regime to attach oneself to.⁵⁷ Listing in the United States could therefore be used to seek private benefits at the expense of minority shareholders if doing so avoids a “more stringent regime,” erects “enforcement obstacles,” or creates the opportunity for self-dealing.⁵⁸

Evaluating the extent to which US-listed Chinese companies adhere to the “Bonding Hypothesis” is especially relevant because it informs the effectiveness of the HFCAA in carrying out its objectives—protecting U.S. investors and deterring Chinese companies. As Chinese companies may enjoy a bonding effect from the PCAOB’s oversight⁵⁹ and disclosure regime imposed by the HFCAA, in theory, the Act will further compel U.S. listings of those Chinese companies that list in the U.S. to “bond” or maximize their publicly held share price.⁶⁰ On the other hand, to the extent that the HFCAA imposes additional accountability on Chinese issuers, the Act will disproportionately deter those Chinese companies that list “to maximize their receipt of the private benefits of control.”⁶¹

However, there are many reasons to doubt that U.S.-listed Chinese companies conform to the bonding hypothesis. First, evidence generally refutes that Chinese companies list overseas as a means to improve their corporate governance.⁶² Second, while the bonding hypothesis was developed to explain why an issuer would *cross-list* in the United States, most U.S.-listed Chinese issuers—79%, as determined by the SEC—list *solely* on U.S. exchanges.⁶³ Lastly, as

57. *Id.* at 149.

58. *Id.*; Fried & Kamar, *supra* note 28, at 50.

59. Phillip T. Lamoreaux et. al, *Audit Regulation and Cost of Equity Capital: Evidence from the PCAOB’s International Inspection Regime*, 37 CONTEMP. ACCT. RSCH. 2348, 2465 (2020) (finding that foreign SEC registrants with auditors from countries that allow PCAOB oversight enjoy a lower cost of capital, which is amplified for companies that lack other quality corporate governance mechanisms).

60. *See* Coffee, *supra* note 46, at 1765.

61. *Id.*

62. *See e.g.*, Li Xian Liu & Jun Li, *Corporate Governance and Listing Location of Chinese Firms: The Bonding Theory Revisited*, 25 J. ASIA PAC. ECON. 40, 54 (2020) (supporting the notion that the main motivation for Chinese firms seeking overseas listing is not to improve corporate governance directly through a regression analysis of eight corporate governance variables on firm valuation of Chinese cross-listed firms).

63. *See* Fried & Kamar, *supra* note 28, at 42; *see also* Securities and Exchange Commission, *Holding Foreign Companies Accountable Act Disclosure*, FED. REG. (Dec. 9, 2021), <https://www.federalregister.gov/documents/2021/12/09/2021-26528/holding-foreign-companies-accountable-act-disclosure#footnote-39-p70030> (“79 percent of registrants covered by the HFCA Act disclose listing only on a U.S. national exchange.”).

evidenced below, there are significant barriers to both public and private enforcement of Chinese issuers listed in the United States. The foregoing reasons, coupled with the accommodating disclosure regime for FPIs, enables the opportunity for Chinese insiders to maximize the benefit of private control.⁶⁴

C. I.C THE UNACCOUNTABLE

The effectiveness of formal law enforcement, particularly against company insiders, is integral to the bonding hypothesis.⁶⁵ Yet, studies reveal that foreign issuers in general have been subject to less public enforcement than domestic issuers.⁶⁶ This is exacerbated for China-based issuers as everything required to enforce the law is unavailable for private plaintiffs and public prosecutors in the United States.⁶⁷ In fact, Chinese cross-listed companies and their management regularly declare themselves that they do not believe they are subject to discipline by American legal institutions.⁶⁸ This can be attributed to the fact that China does not allow extradition, abstains from enforcing U.S. judgments, and inhibits information gathering needed to enforce

64. See *infra* Section I.D; see also Robert J. Jackson, Bradford Lynch-Levy & Daniel J. Taylor, *Holding Foreign Insiders Accountable* (N.Y.U. L. & Econ. Rsch., Working Paper No. 22-16, 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4072797.

65. See Cai, *supra* note 55, at 87–88; see also Coffee, *supra* note 46, at 1782 (positing public and private enforcement and SEC disclosure requirements are responsible for whatever increase in minority protection that results from listing in the US).

66. Coffee, *supra* note 46, at 1794–95; Jordan Siegel, *Can Foreign Firms Bond Themselves Effectively by Renting U.S. Securities Laws?*, 75 J. FIN. ECON. 319, 356–57 (2005) (finding the SEC has rarely taken action against cross-listed firms or their insiders for violations of federal securities law from the period between 1934–2002, even despite publicized findings of misconduct in the issuer’s home country); see Cheng et al., *Securities Litigation Risk for Foreign Companies Listed in the U.S.* (June 18, 2014) (unpublished manuscript) (available at SSRN: https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2163864) (concluding US listed foreign companies experience securities class action lawsuits at about half the rate as do US firms with similar levels of ex ante litigation risk); see also Coffee, *supra* note 46, at 1794–95 (acknowledging public and private enforcement against foreign issuers [that] has been scant but argues the few but high-profile enforcement actions and low visibility enforcement via informal contact, warnings, and administrative enforcement render this far from dispositive).

67. See Fried & Kamar, *supra* note 28, at 1 (including “insiders, the insider’s assets, the firm’s records, and the firm’s assets.”).

68. See Donald Clarke, *The Bonding Effect in Cross-listed Chinese Companies: Is it Real?*, in *ENFORCEMENT OF CORPORATE AND SECURITIES LAW: CHINA AND THE WORLD* 88, 93–94 (Robin Hui Huang & Nicholas Calcina Howson eds., 2017) (examining sample of F-1 statements).

U.S. law.⁶⁹

For starters, China does not have an extradition treaty with the United States.⁷⁰ Apparently, “no Chinese national has ever been extradited to the United States for violation of U.S. securities law or U.S. judicial orders in corporate matters”.⁷¹ The United States also suspended its extradition treaty with Hong Kong in 2020 in response to China’s imposition of national security legislation on the region.⁷² While these insiders may risk extradition through travel, other countries may be increasingly hesitant to extradite Chinese nationals to the United States.⁷³ Therefore, the threat of criminal sanctions on Chinese insiders is largely illusory.

U.S. investors and authorities are inhibited from enforcing U.S. judgements where assets are located in China.⁷⁴ This is because the U.S. and China have not entered into a bilateral enforcement treaty, nor are they signatories to the Convention on Choice of Court Agreements.⁷⁵ Only two Chinese courts have ever enforced a U.S. judgment.⁷⁶ As a result, Chinese insiders can virtually ignore U.S. judgments, leaving voluntary settlements as the only practical recovery option for claims asserted by U.S. investors.⁷⁷

China also impedes information gathering necessary to U.S. investors and authorities to enforce securities and corporate law. The service of process can be lengthy or simply refused with China-based defendants.⁷⁸ Moreover, China “prohibits depositions of its citizens by

69. Fried & Kamar, *supra* note 28, at 13, 15, 17–21.

70. *See* 18 U.S.C. § 3181.

71. Fried & Kamar, *supra* note 28, at 13; *accord* Clarke, *supra* note 68, at 99.

72. *See* The President’s Executive Order on Hong Kong Normalization, 85 Fed. Reg. 43,413 (July 14, 2020) (imposing measures to close preferential treatment of Hong Kong); Press Statement, Morgan Ortagus, Spokesperson, U.S. Department of State, Suspension or Termination of Three Bilateral Agreements with Hong Kong (Aug. 19, 2020), <https://2017-2021.state.gov/suspension-or-termination-of-three-bilateral-agreements-with-hong-kong/>.

73. *See* Fried & Kamar, *supra* note 28, at 14; *see also* Tracy Shelcok & Dan Bilefsky, *Extradition of Huawei Executive Clears a Major Legal Hurdle in Canada*, N.Y. TIMES, (May 27, 2020), <https://www.nytimes.com/2020/05/27/world/canada/huawei-extradition-meng-wanzhou.html>; Press Release, Department of Justice, *Huawei CFO Wanzhou Meng Admits to Misleading Global Financial Institution* (Sept. 24, 2021), <https://www.justice.gov/opa/pr/huawei-cfo-wanzhou-meng-admits-misleading-global-financial-institution> (noting the example of China detaining two Canadian citizens and restricting imports on several Canadian products after Canada arrested the CFO of Huawei to await extradition to the United States).

74. *See* Fried & Kamar, *supra* note 28, at 15.

75. *Id.* at 15–16.

76. *Id.* at 16 (noting “these decisions have no precedential value in China”).

77. *Id.* at 15.

78. *Id.* at 17.

foreigners on its soil", thus forcing U.S. investors and authorities to rely on documentary evidence.⁷⁹ However, China-based defendants are often prohibited from turning over documentary evidence due to China's state secrecy laws and Archives Law.⁸⁰ Therefore, insiders and assets located in China are largely insulated from the reach of U.S. authorities and U.S. private plaintiffs.

Despite this insulation from U.S. law that has effectively shielded Chinese executives from suffering criminal penalties for violations of U.S. securities law, Chinese companies and executives have suffered monetary penalties in both the public and private arena.⁸¹ From 2011–2015, twelve civil suits were brought in federal court by the SEC against companies headquartered in China.⁸² Of those, six cases ended with a Chinese perpetrator paying a penalty.⁸³ As for the private arena, 88 cases involving Chinese companies were filed between January 2011 and October 2015.⁸⁴ The results are "pending or unknown" in 35 cases, 25 cases were dismissed, the plaintiffs won a default judgment in 3 cases, and 25 cases were settled.⁸⁵

Although this modest enforcement may give credence to the bonding hypothesis, the results inevitably depend on the number of cases that *should* have been brought.⁸⁶ Further, the ramifications of these cases may not be felt by company insiders. Given the practical difficulties in forcing "individual Chinese defendants to pay, there is no reason for thinking that plaintiffs will be *more* likely in Chinese cases than otherwise to insist on individual liability as part of a settlement."⁸⁷ Despite this, where U.S. corporate defendants rarely suffer personal financial penalties because a significant proportion of U.S. class action settlements comes from director's and officer's insurance ("DOI") coverage, DOI is relatively rare among Chinese firms.⁸⁸ On one hand, this indicates that a higher proportion of

79. *Id.*

80. *Id.* at 18–19.

81. Clarke, *supra* note 68, at 99.

82. *Id.* at 98.

83. *Id.* at 98–99 (deriving the information from the Securities Class Action Clearinghouse website).

84. *Id.* at 96.

85. *Id.*

86. *Id.* at 99; *see generally infra* Section I.D.

87. Clarke, *supra* note 68, at 98.

88. D&O insurance is relatively new in China and rare across all emerging market firms. Changyuan Xia et al., *Do Directors with Foreign Experience Increase the Corporate Demand for Directors' and Officers' Liability Insurance? Evidence from China*, 119 *ECON. MODELLING* (2023) (indicating 7.2% of Chinese firms in this sample had director's and officer's insurance coverage); *see* Clarke, *supra* note 68, at 98 (reporting that only five percent of Chinese A-share listed companies have purchased director's and officer's

settlement comes from individual wrongdoers. Even if this is true, Chinese defendants may simply chalk this up to the routine cost of doing business.⁸⁹ Given the absence of Chinese enforcement of U.S. judgements, Chinese defendants could simply ignore a U.S. judgement if they felt particularly harmed by the terms. Despite this option, Chinese companies are heavily inclined to settle cases brought by U.S. plaintiffs and authorities.⁹⁰

In essence, Chinese insiders of firms listed in the United States are largely held unaccountable by U.S. plaintiffs and authorities. This is further compounded by the penchant of Chinese issuers to list *only* in the United States.⁹¹ Chinese insiders of these companies are not subject to securities laws in China or elsewhere, making insiders utterly devoid of accountability from anywhere.⁹²

D. I.D FOREIGN PRIVATE ISSUER DISCLOSURE REGIME AND SELF-DEALING

Prior to the passage of the Sarbanes-Oxley Act of 2002 (“SOX”), the SEC did not attempt to regulate the corporate governance of foreign corporations, even when issuers entered the SEC reporting-and-disclosure system.⁹³ Sarbanes Oxley imposed more stringent corporate governance and disclosure requirements for both domestic and foreign issuers—leading to concerns that the U.S. capital markets would lose out on attracting foreign listings.⁹⁴ Driven by these concerns, the SEC acquiesced to pressure to accommodate FPIs.⁹⁵ As a result, Chinese issuers and other FPIs are subject to fewer disclosure requirements rules than domestic issuers.⁹⁶

This disclosure regime of FPIs may be particularly inadequate for U.S.-listed Chinese issuers. As most FPIs were historically subject to

insurance).

89. See Clarke, *supra* note 68, at 98.

90. *Id.*

91. Fried & Kamar, *supra* note 28, at 6.

92. *Id.*

93. Prior to this, internal corporate affairs were left to state corporation law, state blue sky statutes, and stock-exchange-listing requirements. Roberta S. Karmel, *The Securities and Exchange Commission Goes Abroad to Regulate Corporate Governance*, 33 STETSON L. REV. 849 (2004).

94. See *id.* at 862.

95. See Steven Davidoff, *Rhetoric and Reality: A Historical Perspective on the Regulation of FPIs*, 79 U. CIN. L. REV. 619, 624 (2010).

96. See *id.*; see *Disclosure Considerations for China-Based Issuers*, SEC. & EXCH. COMM’N (Nov. 23, 2020), <https://www.sec.gov/corpfin/disclosure-considerations-china-based-issuers>.

regulation on a home country exchange, the disclosure rules frequently reflect this assumption.⁹⁷ For example, FPIs are not required to file quarterly reports via Form 10-Q that domestic issuers must, but must file periodic interim reports in a Form 6-K.⁹⁸ However, Form 6-K requirements are limited when the FPI is not traded on its home country exchange or elsewhere outside the United States.⁹⁹ As many Chinese issuers list solely in the United States with only Chinese SOEs subject to regulation in China, U.S.-listed Chinese issuers can control the “frequency and content of event-driven disclosures.”¹⁰⁰

More significantly, FPIs are also exempt from several conflicts of interest requirements, including Regulation Fair Disclosure (“FD”) and Section 16 of the Exchange Act.¹⁰¹ Both Regulation FD and Section 16 foreclose opportunities for insiders to profit, at the expense of minority shareholders, due to asymmetrical dissemination of material nonpublic information. Regulation FD requires issuers to disclose “material nonpublic information” to all investors at the same time.¹⁰² In its absence, issuers can make selective disclosures to security analysts or institutional investors, allowing them to profit before public dissemination.¹⁰³ Section 16 of the Exchange Act prohibits insiders from engaging in short sales and earning short-swing profits by requiring timely reporting of trades.¹⁰⁴ As a result, Chinese issuers

97. Davidoff, *supra* note 95, at 625.

98. See 17 CFR §§ 240.13a-13, 13a-16; see also 17 CFR § 240.15d-13; 17 CFR § 240.15d-16; see also, Financial Reporting Manual, U.S. SEC. EXCH. COMM’N, <https://www.sec.gov/corpfin/cf-manual/topic-6> (last visited Feb. 25, 2024).

99. *Form 6-K*, U.S. SEC. & EXCH. COMM’N (expiring Nov. 30, 2022), <https://www.sec.gov/about/forms/form6-k.pdf>. Specifically, the form states that an issuer “shall furnish whatever information . . . such issuer (i) makes or is required to make public pursuant to the law of the jurisdiction of its domicile or in which it is incorporated or organized, or (ii) files or is required to file with a stock exchange on which its securities are traded and which was made public by that exchange, or (iii) distributes or is required to distribute to its security holders.” *Id.* at 2.

100. Cf., Tayler Tanner, *Spotify’s Direct Listing and FPIs: Protecting Investors When FPIs List on a U.S. Exchange but Not on Their Home Exchange*, 2019 B.Y.U. REV 573, 587–588 (“As a foreign private issuer not subject to interim disclosures under local listing laws, Spotify could independently decide the frequency and content of its event-driven disclosures.”).

101. 17 CFR § 243.101(b); CFR 17 § 240.3a12-3, <https://www.ecfr.gov/current/title-17/chapter-II/part-240/subpart-A/subject-group-ECFR48fbd3224bf6573/section-240.3a12-3> (explaining that FPIs are also exempt from several proxy statement requirements under Section 14 of the Exchange Act).

102. Intentional disclosures must be made public simultaneously whereas non-intentional disclosure must be made public “promptly”. 17 CFR § 243.100(a), https://www.sec.gov/rules/final/33-7881.htm#P22_3882.

103. See *id.*

104. See 17 CFR § 240.16a-3.

are exempt from Form 4 reporting requirements that require insiders to publicly disclose stock sales electronically within two business days.¹⁰⁵ Instead, Chinese issuers and other FPIs are required only to mail in a physical copy of a Form 144 report. Subsequently, these lesser requirements subject the insiders to less scrutiny and often results in opaque disclosure.¹⁰⁶ This exacerbates enforcement issues because it makes it difficult to even identify Rule 10b-5 insider trading violations.¹⁰⁷

The exemption from Form 4 reporting requirements coupled with the absence of extradition between the U.S. and China likely emboldens Chinese insiders to trade on non-public information more than insiders of any other country.¹⁰⁸ Foreign insiders' stock sales are typically highly opportunistic, and concentrated specifically in companies that are domiciled in non-extradition countries.¹⁰⁹ Of the non-extradition countries, China is the most frequent offender.¹¹⁰ As a result, in recent years, insiders of Chinese companies listed in the United States have avoided billions in losses by trading on insider information ahead of price declines.¹¹¹ For example, an entity controlled by an insider in Alibaba sold \$150 million of stock the day before the Chinese government halted the listing of Ant Group.¹¹² Because Alibaba owned one-third of Ant Group and the listing was expected to increase the value of this stake, Alibaba's stock tumbled

105. See Jackson, Lynch-Levy, & Taylor, *supra* note 64, at 4.

106. See *id.*; see Liz Hoffman & Tom McGinty, *Chinese Executives Sell at the Right Time, Avoiding Billions in Losses*, Wall St. J., (Apr. 5, 2021), <https://www.wsj.com/articles/chinese-executives-sell-at-the-right-time-avoiding-billions-in-losses-11649164573>.

107. See Jesse Fried, *Insider Trading via the Corporation*, 164 U. PA. L. REV. 801, 809 (2014).

108. See Jackson, Lynch-Levy, & Taylor, *supra* note 64, at 12–13. There is also evidence the corporate environment in China is relatively more tilted to controllers and is unsupportive to ordinary investors. See, e.g. Chien-Chung Lin et al., *Insiders and Their Trading Games in China: Law, Enforcement Data, and a Puzzling Question*, 47 IOWA J. CORP. L. 715, 746 (2022) (showing that China's environment of concentrated corporate ownership seems to show a higher degree of pre-announcement run-up when compared to countries with dispersed stock ownership, with a relatively low overall control premium diversion). See generally Danling Yu, CHINESE BUSINESS LAW 113 (Dayuan Han ed., 2019).

109. See Jackson, Lynch-Levy, & Taylor, *supra* note 64, at 12–13.

110. See *id.* at 10 (finding loss avoidance is most pronounced among insiders of Chinese companies).

111. See *id.* at 13 (estimating a lower bound of \$9 billion of losses were avoided by insiders of U.S.-listed companies from non-extradition countries from 2016 to July of 2021); see also Hoffman & McGinty, *supra* note 106. (reviewing the methodology of the study by Jackson, Lynch-Levy & Taylor to conclude that insiders of U.S.-listed Chinese companies have avoided at least \$10 billion of losses between 2016 and mid-2021).

112. See Hoffman & McGinty, *supra* note 106.

by 8% upon the announcement.¹¹³ A similar pattern of well-timed trades have been highlighted across numerous other U.S.-listed Chinese companies.¹¹⁴ In many of these cases, the disclosure of the Form 144 reports fails to even identify which insider the trade is linked to.¹¹⁵ Even though enforcement against Chinese insider trading violators has its practical difficulties, imposing Form 4 reporting requirements on Chinese insiders would not be futile because it subjects insiders to public scrutiny for their trades that can currently be avoided.¹¹⁶

Therefore, the problems with legal enforcements—in conjunction with the disclosure regime of FPIs—grant insiders located in China the opportunity to expropriate minority investors through self-dealing transactions with virtual impunity. Moreover, there is evidence that Chinese insiders seize this opportunity to avoid losses in staggering sums by trading on insider information.¹¹⁷

E. I.E ACCOUNTING OVERSIGHT

As part of the SOX, the PCAOB was conceived in response to the Enron and WorldCom scandals which demonstrated that auditors' self-regulation was insufficient.¹¹⁸ Every accounting firm, whether domestic or foreign, that prepares an audit for a U.S.-listed company must register with and file an annual report with the PCAOB.¹¹⁹ Thereafter, registered accounting firms are statutorily required to be

113. *See id.*

114. *See id.*; *see also* Ryan McMorrow et al., *How China's Tech Bosses Cashed out at the Right Time*, FINANCIAL TIMES (Nov. 6, 2021), <https://www.ft.com/content/41ec575f-d8ee-45d4-b604-fe66566a8c5c> (explaining how executives at Chinese tutoring companies sold shares ahead of government regulation banning the for-profit tutoring sector which plummeted share prices.)

115. *See* McMorrow, *supra* note 114.

116. *See* Jackson, Lynch-Levy, & Taylor, *supra* note 64.

117. *See id.*; *see also* Hoffman & McGinty, *supra* note 106.

118. *See* Hui Huang, *supra* note 11, at 154; *see also* Charles D. Niemeier, Board Member, PCAOB, Speech at the German Public Auditors Congress of 2007, Independent Oversight of the Auditing Profession: Lessons from U.S. History (Nov. 8, 2007), https://pcaobus.org/news-events/speeches/speech-detail/independent-oversight-of-the-auditing-profession-lessons-from-u-s-history_32 (“The peer review system [established under the self-regulatory framework of the audit industry] never resulted in an adverse or qualified report on a major accounting firm . . . Reviewers also failed to follow up on audit risks presented by aggressive business development practice, such as compensation schemes that required auditors to solicit consulting business from audit clients and punished auditors who jeopardized such business by being too tough in audits.”).

119. *See* Hui Huang, *supra* note 11, at 156–57.

periodically inspected by the PCAOB.¹²⁰ Although many foreign accounting firms and regulators initially denied inspections due to restrictions of local laws or objections based on national sovereignty, the PCAOB reached cooperative agreements with 25 foreign jurisdictions from 2005 through 2021.¹²¹ However, the People's Republic of China ("PRC") has long prevented the PCAOB from inspecting auditors in both China and Hong Kong.¹²²

The PCAOB has not systematically inspected China-based accounting firms, which audit hundreds of public companies aggregating over \$1 trillion USD in value.¹²³ China has repeatedly disallowed or hindered the PCAOB access to auditing records on grounds it conflicts with an array of Chinese state secrecy laws.¹²⁴ Although the inability for the PCAOB to inspect audits has been disclosed in China-based issuers filings,¹²⁵ disclosure alone is fruitless for a capital market system built on the bedrock of "high quality, reliable financial statements."¹²⁶

120. *See id.* at 157.

121. *See id.* at 159–61; *PCAOB Cooperative Arrangements with Non-U.S. Regulators*, PCAOB, <https://pcaobus.org/oversight/international/regulatorycooperation> (last visited Mar. 6, 2023). In recent years, Belgium, France, Mainland China, and Hong Kong have not granted access to PCAOB inspections but Belgium and France reached or renewed cooperative arrangements with the PCAOB in April of 2021. *See id.*

122. *See* Hui Huang, *supra* note 11, at 163, n.113.

123. Fried & Kamar, *supra* note 28, at 28. Congress created immense leverage for the PCAOB's disclosure requirements by passing the HFCAA, which enabled "historic and unprecedented access" to inspect and launch investigations into Chinese firms. News Release, PCAOB, PCAOB Statement of the Board upon Determining the HFCAA Enables Complete Access to Inspect, Investigate Chinese Firms for First Time in History (Dec. 15, 2022) available at <https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-secures-complete-access-to-inspect-investigate-chinese-firms-for-first-time-in-history>. As Chair Erica Y. Williams for the PCAOB reiterated, "Congress sent a clear message with that legislation that access to U.S. capital markets is a privilege and not a right, and China received that message loud and clear." *Id.*

124. Fried & Kamar, *supra* note 28, at 13–28 (arguing the protection of state secrecy laws is not a fundamental barrier to allow PCAOB oversight, but there are technical and political difficulties).

125. Gillis, *supra* note 28.

126. U.S. Sec. & Exch. Comm'n, Statement on the Vital Role of Audit Quality and Regulatory Access to Audit and Other Information Internationally—Discussion of Current Information Access Challenges with Respect to U.S.-listed Companies with Significant Operations in China (Dec. 7, 2018), <https://www.sec.gov/news/public-statement/statement-vital-role-audit-quality-and-regulatory-access-audit-and-other>.

II. ANALYSIS

A. THE LEAD UP TO THE HOLDING FOREIGN COMPANIES ACCOUNTABLE ACT.

Amid overarching political tensions between the world's superpowers, The Holding Foreign Companies Accountable Act ("HFCAA") was first introduced to the US Senate on March 28, 2019, to address the gap in PCAOB oversight.¹²⁷ Notably, the committee hearings indicate that deterrence of Chinese companies, rather than investor protection, was the preliminary motivation of the HFCAA.¹²⁸ The members acknowledged concerns over the adverse impact that prohibiting trading and "perhaps an overcorrection" would have on ordinary investors and retirement accounts.¹²⁹ Less disruptive solutions were proposed,¹³⁰ but were overcome with concerns over the declining frequency of American IPOs in conjunction with the ever-increasing frequency of Chinese IPOs.¹³¹ Later, attention was turned to the deterrent effect of the increased compliance and disclosure costs from the bills introduced, including the HFCAA, because "it is not right [for China] to have deferential treatment."¹³² The acknowledgement of potential disruptiveness to ordinary investors suggests deterrence of Chinese companies from U.S. securities markets was the driving motivation prior to the Luckin Coffee debacle.

The Luckin Coffee fraud provided a convenient catalyst for HFCAA, highlighting the problems with the lack of PCAOB oversight of Chinese listed securities where U.S. investors have little legal recourse.¹³³ Luckin Coffee attracted high profile investors as it listed on the NASDAQ in May of 2019, seeking to become the China-based equivalent of Starbucks.¹³⁴ However, in January of 2020, the

127. See S. 945, 116th Cong. (2020), <https://www.congress.gov/bill/116th-congress/senate-bill/945/text>.

128. See *Putting Investors First: Examining Proposals to Strengthen Enforcement Against Securities Law Violators: Hearing Before the Subcomm. on Inv. Prot., Entrepreneurship, & Cap. Mkts. of the H. Comm. on Fin. Servs.*, 116th Cong. (2019).

129. *Id.* at 16.

130. Andrew N. Volmer, a Virginia law professor, proposes a solution similar to a Section 12(j) proceeding as well as a "bonding or insurance policy requirement." See *id.*

131. *Id.*

132. See *id.* at 20.

133. Qingxiu Bu, *The Anatomy of Holding Foreign Companies Accountable Act (HFCAA): A Panacea or a Double-edge Sword?*, 16 CAP. MKTS. L.J. 503, 505 (2021).

134. *Id.*

prominent short seller Muddy Waters Research released an eighty-nine page report claiming Luckin fabricated its financials.¹³⁵ The anonymous contributor employed extensive on-the-ground surveillance and investigations to reach this conclusion.¹³⁶ \$11 billion USD of investor wealth vanished by the time it was delisted on June 29, 2020.¹³⁷ In the end, Luckin Coffee agreed to pay a \$180 million penalty to the SEC for fabricating more than \$300 million of sales using related parties to create false transactions from April 2019 to January of 2020.¹³⁸ Even Chinese Regulators opened investigations and threatened criminal charges against its founder, likely to rebuke the spillover damage Luckin had on other Chinese companies listed in the U.S.¹³⁹ The HFCAA was considered and passed the Senate shortly after the Luckin Coffee implosion was revealed, before being signed into law by President Trump on December 18, 2020.¹⁴⁰

B. THE PROVISIONS OF THE HOLDING FOREIGN COMPANIES ACCOUNTABLE ACT

The HFCAA can be broken down into two components. First, the Act mandates a trading ban in the securities of issuers who do not allow PCAOB inspections.¹⁴¹ The Act requires the SEC to identify all covered issuers¹⁴² whose financial statements were audited by registered public accounting firms with an office or a branch in a foreign jurisdiction which the PCAOB has been unable to inspect due to a position taken by a foreign authority.¹⁴³ If the SEC determines

135. Peter Molk & Frank Partnoy, *The Long-Term Effects of Short Selling and Negative Activism*, 2022 U. ILL. L. REV. 1, 4 (2022); see also *Luckin Coffee: Fraud + Fundamentally Broken Business* (2020), <https://drive.google.com/file/d/1LKOYmpXVo1ssbWQx8j4G3-strg6mpQ7F/view> [hereinafter *Luckin Coffee: Fraud + Fundamentally Broken*].

136. See *Luckin Coffee: Fraud + Fundamentally Broken*, *supra* note 135.

137. Bu, *supra* note 133, at 505–06.

138. Press Release, U.S. Sec. & Exch. Comm'n, *Luckin Coffee Agrees to Pay \$180 Million Penalty to Settle Accounting Fraud Charges* (Dec. 16, 2020), <https://www.sec.gov/news/press-release/2020-319>.

139. See Henry Sender, *Luckin Coffee Investigated by Top Chinese Regulator*, FIN. TIMES (Apr. 27, 2020), <https://www.ft.com/content/ee2cebd2-92e9-49da-9c17-eb39fe3af820>. However, at the time of this writing, it is not clear that the founder of Luckin Coffee was ever actually prosecuted.

140. See S. 945, 116th Cong. (2020), <https://www.congress.gov/bill/116th-congress/senate-bill/945/text>.

141. See *id.*

142. The Act requires the SEC to identify each “covered issuer” that fits the ensuing criteria. *Holding Foreign Companies Accountable Act*, U.S. SEC. & EXCH. COMM’N, <https://www.sec.gov/hfcaa>.

143. S. 945, 116th Cong. (2020), <https://www.congress.gov/bill/116th->

that the PCAOB is not able to inspect the issuer's audits for three consecutive years, the Act requires the SEC to prohibit trading of that issuer's securities.¹⁴⁴ This trading prohibition extends beyond delisting on a national security exchange to include trading on over-the-counter markets.¹⁴⁵

The second component of the HFCAA is the imposition of disclosure requirements that attempt to increase transparency regarding the government ownership and political influence over China-based issuers for each year the PCAOB is unable to inspect the issuer's audits. The Act requires covered issuers identified by the SEC to submit documentation that establishes the issuer "is not owned or controlled" by a governmental entity in the foreign jurisdiction where its financial statements were audited each non-inspection year.¹⁴⁶ If the issuer is also a U.S. foreign issuer, the registered accounting firm is required to disclose the following additional information in its audit reports for each year the PCAOB is unable to inspect:

- (1) That a registered public accounting firm has prepared an audit report during the period covered;
- (2) The percentage of shares owned by government entities where the issuer is incorporated or otherwise organized;
- (3) Whether government entities in the foreign jurisdiction where the registered public accounting firm has a branch that audit the issuer's financial reporting have a controlling financial interest in the issuer;
- (4) The name of each Chinese Communist Party ("CCP") official who is a member of the board of directors of the issuer, or of its affiliated Chinese operating entity;
- (5) Whether the organizing document of the issuer contains any charter of the CCP and the text of such charter.¹⁴⁷

congress/senate-bill/945/text (last visited Jan. 5, 2023).

144. *Id.* The trading prohibition can be lifted after five years if an issuer obtains a registered public accounting firm the PCAOB is able to inspect. *See id.*

145. *Id.*

146. *Id.*

147. *Id.*

C. ACCOUNTING OVERSIGHT AND CHINA'S RESPONSE

Since China-based issuers' and their auditor's compliance with the HFCAA jeopardized violations of incompatible Chinese laws, the HFCAA shifted the calculus of China's forbiddance of PCAOB audits by imposing a verifiable sanction of delisting.¹⁴⁸ Further, Congress effectively accelerated the delisting threat when it introduced a bill to shorten the trading ban from three years to two years.¹⁴⁹ Even though mass delisting would certainly harm U.S. exchanges and deprive investors, the United States arguably possessed leverage as Chinese companies rely on the opportunity to list in the U.S. more than U.S. exchanges rely on China for listings.¹⁵⁰

Perhaps as a result, the Chinese Securities Regulatory Commission ("CSRC") acquiesced by slashing its conflicting securities rule stating, "on-site inspections will be dominated by domestic regulators or depend on the conclusions of inspections by domestic regulators."¹⁵¹ Months later, the PCAOB announced it has secured complete access to inspect and investigate registered public accounting firms headquartered in mainland China and Hong Kong for the first time in history on December 15, 2022, attributing the access to the leverage created by the HFCAA.¹⁵²

Even assuming unhindered PCAOB access to inspect auditors, the enforcement regime against auditors may not be sufficient to incentivize high quality audits.¹⁵³ Chinese auditors have frequently been accused, implicitly or otherwise, of signing off on shotty audits in exchange for unreasonably high profit margins.¹⁵⁴ Therefore,

148. See Grosword Ozery, *supra* note 3, at 994 (noting the Act parts ways with the financial risk disclosure approach).

149. See H.R. 6285, 117th Cong. (2021-2022), <https://www.congress.gov/bill/117th-congress/house-bill/6285?s=1&r=44>.

150. Prior to the passage of the HFCAA, China-based stocks listed in the U.S. accounted for over 7.6% of Chinese domestic listings. Conversely, China-based stocks comprised just over 2% of the listings on U.S. exchanges. See *infra* Table 1; see Bloomberg Terminal data.

151. *Officials of Relevant CSRC Department Answered Reporter Questions*, CSRC (Apr. 1, 2022), http://www.csrc.gov.cn/csrc_en/c102030/c2274405/content.shtml.

152. The announcement was only made after verifying China's compliance. See Williams, *supra* note 3.

153. Colleen Honigsberg, *The Case for Individual Audit Partner Accountability*, 72 VAND. L.

REV. 1871 (2019) (arguing for establishing a reputation market for individual audit partners in light of the fact that one-quarter of all audits inspected by the PCAOB from 2005 through 2016 were deemed severely deficient).

154. See *e.g.*, Hui Huang, *supra* note 11, at 169 ("Deloitte signed off six previous audit reports until a research firm in 2011 alleged that the company's profit margin was unreasonably high").

auditors must be deterred, reputationally or monetarily, from the incentive to look the other way. The PCAOB can implement disciplinary orders relating to inspection infractions, although these generally amount to a modest sum.¹⁵⁵ More significantly, PCAOB inspections may lead to enforcement actions by the DOJ and the SEC, who generally bring enforcement actions against accounting firms in criminal or fraud cases.¹⁵⁶ Yet, the lack of extradition constrains the power to bring criminal actions against auditors located in China.

Nonetheless, PCAOB inspection of Chinese auditors certainly improves the existing oversight of short sellers.¹⁵⁷ Activist short sellers have filled the void of the PCAOB oversight to some extent, uncovering fraudulent activities leading to SEC investigations.¹⁵⁸ The “intensive forensic approach” taken by Muddy Waters to uncover the Luckin Coffee fraud may even surpass the capabilities of a limited resourced PCAOB.¹⁵⁹ However, the vigilante role of activist short sellers is limited by their financial incentive to target overvalued companies and have been criticized for market manipulation.¹⁶⁰ Therefore, the PCAOB’s comprehensive oversight of auditors fills in the more sporadic oversight of activist short sellers.¹⁶¹ However, the

155. For enforcement actions against accountants and accounting firms see, *Enforcement Actions*, PCAOB <https://pcaobus.org/oversight/enforcement/enforcement-actions?country=China> (last visited Mar. 7, 2023).

156. Honigsberg *supra* note 118 at 1876–90. *See e.g., Deloitte’s Chinese Affiliate to Pay \$20 Million Penalty for Asking Audit Clients to Conduct Their Own Audit Work*, U.S. SEC. & EXCH. COMM’N (Sept. 29, 2022), <https://www.sec.gov/news/press-release/2022-176>.

157. *See Williams, supra* note 3.

158. *See* Teresa A. Teng, *Mismatched Regulatory Regimes: How Chinese Reverse Mergers—and China MediaExpress Holdings, Inc.—Evaded Scrutiny Through Regulatory Conflicts and Loopholes*, 11 N.Y.U. J.L. & BUS. 387, 406–11 (2014) (highlighting activists short sellers’ uncovering of China MediaExpress in 2011, leading to SEC investigations); Luc Paugam et al., *Developing Narrative Economics to Understand Financial Market Dynamics: An Analysis of Activist Short Sellers’ Rhetoric*, 39 CONTEMP. ACCT. RSCH. 1809, 1817–18 (2020) (showing 20.5% of activist short seller research reports from 2007 to mid-2018 targeted a Chinese firm).

159. The report released by Muddy Waters uncovering the Luckin Coffee fraud indicates the contributors examined over 25,000 receipts and over 11,000 hours of video footage. *See* Andrew Verstein, *Mixed Motives Insider Trading*, 106 IOWA L. REV. 1253, 1280–81 (2021).

160. *See id.*; *see also* Joanna Lee, *Activist Short Sellers: Market Manipulators or Market Protectors?*, 32 REV. BANKING & FIN. L. 274, 276–78 (2013).

161. PCAOB oversight may also lead to synergies in oversight with short sellers. For example, short seller J Capital Research indicated the insider sales of Chinese Company YMM ahead of PCAOB audits raised red flags and provided diagrams to assist the PCAOB in its investigation. *See Full Truck Alliance (YMM) A Round Trip for Investors?*, J CAP. RSCH. 47 (Jan. 24, 2023), http://www.jcapitalresearch.com/uploads/2/0/0/3/20032477/2023_01_24_ymm.p

guarantee of such comprehensive oversight remains tenuous.¹⁶²

Historically, there is reason to doubt the sustainability of PCAOB access to inspect Chinese auditors. The CSRC and the Chinese Ministry of Finance signed a Memorandum of Understanding on Enforcement Cooperation (“MoU”) with the PCAOB in 2013 to establish a cooperative framework for the production and exchange of audit documents.¹⁶³ Under the MoU, the PCAOB could request audit documents subject to the approval of Chinese regulators.¹⁶⁴ However, to the dissatisfaction of the PCAOB, the MoU overwhelmingly failed as the CSRC only provided access on four instances with one joint inspection at a registered audit firm.¹⁶⁵ The only substantive difference between the failed MoU and the HFCAA is the penalty of mandatory delisting.

Additionally, the CSRC retains the authority to approve foreign inspections.¹⁶⁶ Moreover, the CSRC maneuvered to expand this authority when it proposed new rules strengthening filing requirements for domestic companies seeking overseas listings and expanding the scope to require variable interest entities to seek regulatory approval prior to listing overseas.¹⁶⁷ Not only does this serve to grant the CSRC gatekeeping access over all foreign listings,

df.

162. See discussion *infra* Section II.C.

163. *PCAOB Enters into Enforcement Cooperation Agreement with Chinese Regulators*, PCAOB (May 24, 2013), https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-enters-into-enforcement-cooperation-agreement-with-chinese-regulators_430.

164. See Hui Huang, *supra* note 11, at 176.

165. *Id.* at 177 (“In the PCAOB’s own words, ‘since signing the MOU in 2013, Chinese cooperation has not been sufficient for the PCAOB to obtain timely access to relevant documents and testimony necessary to carry out our mission’”).

166. See *China’s Regulators Warm to American Listings*, THE ECONOMIST (Apr. 9, 2022), <https://www.economist.com/business/2022/04/09/chinas-regulators-warm-to-american-listings>; see *infra* notes 167–68 and accompanying text.

167. See *The CSRC Solicits Public Comments on Revision to the Provisions on Strengthening Confidentiality and Archives Administration of Overseas Securities Offering and Listing by Domestic Companies*, CSRC (Apr. 1, 2022), http://www.csrc.gov.cn/csrc_en/c102030/c2274356/content.shtml [hereinafter CSRC Overseas Listing Rules]; see generally *Provisions on Strengthening Confidentiality and Archives Administration of Overseas Securities Offering and Listing by Domestic Companies*, CSRC (April 1, 2022) (Draft for Comments), [http://www.csrc.gov.cn/csrc_en/c102030/c2274356/2274356/files/Provisions%20on%20Strengthening%20Confidentiality%20and%20Archives%20Administration%20of%20Overseas%20Securities%20Offering%20and%20Listing%20by%20Domestic%20Companies_\(Draft%20for%20Comments\).pdf](http://www.csrc.gov.cn/csrc_en/c102030/c2274356/2274356/files/Provisions%20on%20Strengthening%20Confidentiality%20and%20Archives%20Administration%20of%20Overseas%20Securities%20Offering%20and%20Listing%20by%20Domestic%20Companies_(Draft%20for%20Comments).pdf); see also Kane Wu & Xie Yu, *Explainer: How China’s New Offshore Listing Rules Will Work*, REUTERS (Dec. 29, 2021), <https://www.reuters.com/markets/asia/how-chinas-new-offshore-listing-rules-will-work-2021-12-29/>.

but it gives the CSRC jurisdiction to inspect these companies and their audit firms.¹⁶⁸ This is important because it forecloses an argument used by Chinese auditors to shutter the CSRC from inspecting its audits.

China-based auditors have used incongruent U.S. and Chinese laws as a shield against regulators, likely to cover their own deficiencies.¹⁶⁹ The Big Four audit firms all argued that compliance with the PCAOB's request for access to audit documents would violate Chinese law following the reverse merger scandals without taking the initiative to request approval from Chinese regulators.¹⁷⁰ Moreover, China-based auditors have employed this argument against inspection by not only the PCAOB and the SEC, but Hong Kong's securities regulator—the Securities and Futures Commission ("SFC")—and the CSRC itself. In 2010, the SFC requested audit documents from Ernst and Young ("EY") to investigate false accounting by a listing applicant.¹⁷¹ EY denied access on the grounds of state sought audit working papers in an investigation to a China-based listing applicant.¹⁷² EY's Chinese mainland counterpart also refused to hand over documents to the CSRC upon request, claiming lack of CSRC jurisdiction because the firm was listed in Hong Kong.¹⁷³ Subsequently, a Hong Kong court ordered EY to produce the accounting records after EY produced no evidence that the audit working papers contained state secrets or even commercial secrets.¹⁷⁴

Auditors are unlikely to be able to effectively claim the existence of state secrets as a shield to inspection by both the CSRC and the PCAOB going forward because the CSRC's new rules make clear that the CSRC has authority over all Chinese domestic companies, regardless of the mechanisms they utilize to list.¹⁷⁵ Therefore, the SEC can determine that an auditor's refusal to allow PCAOB inspection on the basis of state secrets constitutes "a position taken by a foreign

168. See Hui Huang, *supra* note 11, at 186 (explaining that because "approval is needed for overseas listings only if the company is incorporated in China . . . the CSRC has no jurisdiction or responsibility in relation to [companies incorporated offshore].").

169. See *id.* at 173 (explaining auditors have refused to hand over documents citing only that they may violate Chinese state secret laws).

170. See *id.* at 174–75.

171. *Id.* at 173.

172. *Id.*

173. *Id.* at 174.

174. *Id.*

175. See CRSC Overseas Listing Rules, *supra* note 167.

authority” under the HFCAA.¹⁷⁶ In effect, the CSRC forfeiture of its role as the gatekeeper of PCAOB inspection enables the regulator to facilitate delisting by denying PCAOB inspection.

Moreover, Chinese regulators have correspondingly tightened their control of Chinese companies seeking listings overseas since the passage of the HFCAA.¹⁷⁷ Regulators have recently constrained a number of prominent companies from listing their securities on U.S. exchanges.¹⁷⁸ Effective in February of 2022, the Cyberspace Administration of China (“CAC”) and CSRC issued rules requiring mandatory review for any personal information of more than one million users prior to new overseas listings.¹⁷⁹ After a long period of review from the CAC due to data concerns, DiDi Global delisted from the NYSE in June of 2022.¹⁸⁰ These actions force certain Chinese companies to list domestically and hinder the more dynamic data-oriented firms from listing in the U.S.

D. DISCLOSURE FOR WHOM?

The HFCAA disclosure provisions are both unique and unprecedented. The provisions narrowly target Chinese issuers while retaining some generally applicable requirements to any Issuer whose audits PCAOB is unable to inspect.¹⁸¹ There has never been a legal requirement in the U.S. for companies to disclose “political party affiliations of management and oversight” or “the political origins of any portion of a registrant’s articles of incorporation.”¹⁸²

176. See Holding Federal Companies Accountable Act, Pub. L. No. 116-222, 134 Stat. 1063 (codified as amended in scattered sections of 15 U.S.C.).

177. See CRSC Overseas Listing Rules, *supra* note 167.

178. See Keith Zhai & Jing Yang, *China Targets Firms Listed Overseas After Launching Didi Probe*, Wall St. J. (July 6, 2021), <https://www.wsj.com/articles/china-to-revise-rules-and-strengthen-supervision-of-overseas-listings-11625572533>.

179. *Guojia hulanwang xinxi bangongshi guanyu “wangluo anquan shencha ban fa(xiu ding cao’an zhengqiu yijian gao)” gongkai zhengqiu yijian de tongzhi* (国家互联网信息办公室关于《网络安全审查办法(修订草案征求意见稿)》公开征求意见的通知) [Notice of the State Internet Information Office on the Public Comments on the “Measures for Network Security Review], CYBERSPACE ADMIN. OF CHINA (July 10, 2021), http://www.cac.gov.cn/2021-07/10/c_1627503724456684.htm; see also DigiChina, *Translation: Cybersecurity Review Measures*, STANF. UNIV. (July 12, 2021), <https://digichina.stanford.edu/work/translation-cybersecurity-review-measures-revised-draft-for-comment-july-2021>.

180. Li, *supra* note 39.

181. See *id.*

182. Jessica Kelly, *Comment on Interim Final Rule to Holding Foreign Companies Accountable Act Disclosure*, LEXIS, [File Number S7-03-21] (Apr. 30, 2021), <https://plus.lexis.com/api/permalink/82480965-2332-4d56-8239-5960bda2478d/?context=1530671>.

This is so because the disclosure provisions are designed to address a reciprocally unprecedented situation to the West — “a dominant political party inserting itself into corporate charters to intervene in corporate management.”¹⁸³ Chinese leadership introduced a “party building” (*dangjian*) policy in 2015 to formalize the role of the CCP in the corporate governance of Chinese SOEs.¹⁸⁴ To implement the policy, the CCP circulated “templates of model corporate charter amendments.”¹⁸⁵ Although the party building policy is directed at SOEs, privately owned enterprises also voluntarily adopted provisions in their corporate charter.¹⁸⁶ As a result, “equity ownership alone does not reveal the extent to which a given firm is subject to influence by the party-state.”¹⁸⁷

Accordingly, the disclosure provisions attempt to encapsulate the multifaceted influence of the PRC government on Chinese companies beyond mere ownership.¹⁸⁸ The operative definition of “owned or controlled”¹⁸⁹ in the HFCAA is broad, enabling an SEC interpretation that could consider *any* China-based issuer to be controlled by the Chinese government.¹⁹⁰ Consequently, the definition effectively imposes compliance costs across the board for China-based U.S.-listed companies unable to be inspected by the PCAOB in any given year.¹⁹¹

183. Lauren Yu-Hsin Lin & Curtis J. Milhaupt, *Party Building or Noisy Signaling? The Contours of Political Conformity in Chinese Corporate Governance* 50 J. L. STUD. 187, 188 (2021) (quoting from Lauren Yu-Hsin Lin, Re-Jin Guo, & Christopher Chen, *The Effect of Political Influence on Corporate Valuation: Evidence From Party-Building Reform in China*, 73 INT'L REV. L. AND ECON 106, 120 (2023)).

184. The *dangjian* policy shores up party influence to counterbalance the influence of additional private capital through “mixed ownership” strategy designed to improve corporate governance and market orientation. *See id.*

185. *Id.* (noting the provisions varied in from “purely symbolic to highly substantive” in effect).

186. *Id.* at 189 (noting that of Chinese A-share listed companies, 90% of SOEs and 6% of privately owned enterprises adopted SOE reform provisions in their corporate charter).

187. *Id.* at 195.

188. *See generally* Groszold Ozery, *supra* note 3, at 968–91.

189. The Exchange Act Rules define control as “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract, or otherwise”. 17 CFR § 230.405. The SEC declared the meaning of the terms owned or controlled “are reasonably read to have the same meaning as the term “control” as used in the Exchange Act and the Exchange Act rules”. *See* Holding Foreign Companies Accountable Act Disclosure, 86 Fed. Reg. 70027 (Dec. 9, 2021) (to be codified at 17 C.F.R. pt. 230).

190. Groszold Ozery, *supra* note 3, at 996.

191. *See e.g.*, Comment Letter from China Petrol. & Chemic. Corp., (Apr. 30, 2021) (on file with the Sec. & Exch. Comm'n, S7-03-21) (“Repeated disclosure will translate into additional unnecessary compliance costs . . .”).

Still, these provisions provide limited functional utility for investors. For one, fraud cases in China-based U.S. issuers have not involved state-owned companies.¹⁹² Second, it is exceedingly difficult to identify PRC control over Chinese companies, but investors can assume the CCP has some scope of influence on the firm regardless of disclosure.¹⁹³ This may misguide investors to believe that the Chinese government exerts more influence over routine decisions than it does.¹⁹⁴ Rather, the disclosure provisions act as a hook to incentivize continued PCAOB access by imposing cost on the issuer. Crucially, these costs may also be passed on to the Chinese government.

The provisions are likely designed to aid in identifying potential national security threats.¹⁹⁵ Just prior to signing the HFCAA, President Trump issued an Executive Order to curb U.S. investment in fueling the PRC's growing military-industrial complex.¹⁹⁶ The Order bars U.S. persons from transacting in the "publicly traded securities"¹⁹⁷ of any "Communist Chinese Military Company."¹⁹⁸ President Biden then amended this Executive Order, expanding the scope to include "Chinese surveillance technology outside the PRC."¹⁹⁹ The Department of Defense identified a blacklist of 44 entities—including not only defense contractors but "Chinese companies that produce bridges, supercomputers, video surveillance equipment, [and] agrochemicals . . ." ²⁰⁰ The blacklist has resulted in index providers removing Chinese firms from their indices and successfully pressured the NYSE to delist three Chinese telecom firms from their exchange.²⁰¹

192. See Grosword Ozery, *supra* note 3, at 995.

193. *Id.* at 997.

194. See *id.* at 996; see also Lin & Milhaupt, *supra* note 183 at 195 ("[W]hile the state exercises less control over SOEs than is commonly assumed, it exercises more control over private firms than ownership status alone would suggest.").

195. See Grosword Ozery, *supra* note 3, at 999–1003; see also Holding Foreign Companies Accountable Act Disclosure, 86 Fed. Reg. 70027, 70029 (Dec. 9, 2021) <https://www.federalregister.gov/documents/2021/12/09/2021-26528/holding-foreign-companies-accountable-act-disclosure#footnote-39-p70030> ("Of the 273 Commission-Identified Issuers, five are listed in the Annex to Executive Order 14032 as issuers that are affiliated with the Chinese military.").

196. Exec. Order No. 13959, 85 Fed. Reg. 73185 (Nov. 12, 2020).

197. See *id.* (including "any securities that are derivatives" or that are "designed to provide investment exposure").

198. See *id.* at 73186.

199. Exec. Order No. 14032, 86 Fed. Reg. 30145 (June 3, 2021).

200. Grosword Ozery, *supra* note 3, at 1000–01. For the full list of companies, see News Release, Dep't of Def., DPD Releases List of Additional Companies, In Accordance with Section 1237 of FY99 NDAA (Jan. 14, 2021) (on file with the Dep't of Def.).

201. Grosword Ozery, *supra* note 3, at 1002; see *Benchmark Index Providers Remove Chinese firms After U.S. Investment Ban*, REUTERS (Jan. 5, 2021), <https://www.reuters.com/markets/asia/benchmark-index-providers-remove->

The identification of PRC influence on Chinese companies under the HFCAA disclosure requirements help contribute to the identification of a growing web of “Communist Chinese Military Companies” stemming from China’s Military-Civil Fusion plan.²⁰² According to this plan, the PRC integrates the military and civilian sector to modernize the Chinese Military through “the mutual transfer of dual-use technologies.”²⁰³ However, the provisions have shortcomings in meaningfully discerning an issuer’s relationship with the Chinese government to identify specific national security threats.²⁰⁴ To add, Chinese issuers may not be sufficiently incentivized to provide quality disclosure unless the SEC responds with frequent enforcement actions. Nonetheless, even if the information from HFCAA disclosure rarely assists in the identification of Chinese Military Companies, the number of such companies continues to increase with the Military-Civil Fusion plan.²⁰⁵ With this development, an increasing number of China-based companies risk being delisted or are otherwise deterred from listing in the United States—whether through the HFCAA or Executive Order.

III. THE EFFECT OF THE HFCAA ON LISTINGS

From the perspective of investor protection, the HFCAA is limited

chinese-firms-after-us-investment-ban-2021-01-05/; see also John McCrank & Anirban Sen, *NYSE to Delist Three Chinese Telecoms in Dizzying About-face*, REUTERS (Jan. 6, 2021), <https://www.reuters.com/article/us-china-usa-telecom/nyse-to-delist-three-chinese-telecoms-in-dizzying-about-face-idUSKBN29B1TR>.

202. Grosword Ozery, *supra* note 3, at 1001.

203. See *The “13th Five-Year” Special Plan for S&T Military-Civil Fusion Development*, CENTRE FOR SEC. AND EMERGING TECH. (June 24, 2020), <https://cset.georgetown.edu/publication/the-13th-five-year-special-plan-for-st-military-civil-fusion-development/#:~:text=The%20plan%20aims%20to%20reduce%20existing%20stovepipes%20between,other%20resources%20between%20the%20military%20and%20civilian%20sectors>.

204. Grosword Ozery, *supra* note 3, at 1002 (“[A]dditional disclosures about the operations of the issuer, their production lines, major clients, funding sources, operating assets, etc. are potentially more informative . . .”). Compare Comment 2, recommending specific disclosure of board members current and past positions, and Comment 3, recommending the expansion of disclosure provisions to encapsulate other highly substantive amendments altering “corporate governance practices in favor of CCP influence” of Curtis J. Milhaupt & Lauren Yu-Hsin Lin, Comment Letter on Interim Final Rule of Holding Foreign Companies Accountable Act Disclosure (Apr. 5, 2021), (on file with the Sec. & Exch. Comm’n, S7-03-21), with Holding Foreign Companies Accountable Act Disclosure, 86 Fed. Reg. 70027, 70030 (Dec. 9, 2021), (rejecting Comment 2 and Comment 3 submitted by Milhaupt and Lin in the Final Amendments).

205. Grosword Ozery, *supra* note 3, at 1001.

to redressing the denial of PCAOB oversight of accounting firms. While the Act may result in increased PCAOB inspection infractions and lead to additional SEC enforcement against Chinese issuers and auditors alike, the core barriers of legal enforcement against Chinese insiders remain. To add to the limitations, the HFCAA has resulted in unintended ramifications as the PRC has exerted increasing influence over private companies since the Act's passage.²⁰⁶ Nonetheless, the HFCAA may deter Chinese companies from listing in the United States. To this point, the fact that the CSRC retains the authority to oversee audits, the CSRC and CAC have increased their authority over Chinese firm's overseas listing destinations, and the likely purpose of the disclosure provisions in identifying national security threats, all support the notion that Chinese companies will be deterred.

Yet, at a glance, any deterrence effect appears to be isolated to SOEs. In addition to the NYSE delisting of the three Chinese Telecom companies,²⁰⁷ five state-owned Chinese companies—China Life Insurance, PetroChina, Sinopec, Aluminum Corporation of China and Sinopec Shanghai Petrochemical—announced they had notified the NYSE and applied for voluntary delisting in August of 2022.²⁰⁸ Following this, two Chinese airlines announced they would delist from the NYSE.²⁰⁹ The voluntary delistings are rooted in Chinese national security concerns as the safeguarding of state secrets from the PCAOB takes priority over listing in the United States.²¹⁰ While this fulfills the policy objective of the HFCAA to prevent companies owned or controlled by the Chinese government from listing and raising capital in the United States, recall that SOEs have not been the problematic, fraud-ridden firms that ought to be deterred to protect U.S. investors.²¹¹

206. See Holding Foreign Companies Accountable Act Disclosure, 86 Fed. Reg. 70027, 70031 (Dec. 9, 2021).

207. See McCrank & Sen, *supra* note 201.

208. *Five Chinese State-Owned Companies, Under Scrutiny in U.S., Will Delist from NYSE*, REUTERS (Aug. 12, 2022), <https://www.reuters.com/business/finance/several-chinese-state-owned-companies-delist-nyse-2022-08-12>.

209. Iris Ouyang, *China Southern Airlines, China Eastern Airlines to Delist from NYSE Amid Exodus of State-Owned Enterprises from US Exchanges*, S. CHINA MORNING POST (Jan. 14, 2023, 5:30 PM), <https://www.scmp.com/business/banking-finance/article/3206830/china-southern-airlines-china-eastern-airlines-delist-nyse-amid-exodus-state-owned-enterprises-us>.

210. Hui Huang *supra* note 11, at 163 (noting in a 2009 policy statement, the Chinese State council published plans for the accounting industry which explicitly asked companies that are listed in foreign markets, especially SOEs, to preferentially choose those accounting firms that are beneficial “to protecting the safety of national economic information”); *Id.*

211. See Grosword Ozery, *supra* note 3, at 995; see also Fried & Kamar, *supra* note 28, at 22–23 (detailing the fraud-ridden reverse merger firms). *But cf.* China Mobile

On the other hand, some Chinese companies may enjoy a bonding effect from the PCAOB's oversight and additional disclosure requirements, which compels them to list in the United States.²¹² In fact, PCAOB board members have indicated the PCAOB serves not only to benefit the public through reliable information, but also to benefit companies in the form of a lower cost of capital.²¹³ Even if the benefit of a lower cost of capital outweighs the additional cost and risk imposed by the HFCAA, the decision on whether to list in the United States is far from a binary choice—Chinese firms are faced with several alternatives.²¹⁴ While the U.S. is raising the threshold for Chinese companies to raise capital on U.S. exchanges, China, Hong Kong, and Europe are correspondingly relaxing measures to facilitate listings.²¹⁵

A. EUROPEAN EXCHANGES

With the increased regulatory hurdles of the HFCAA, some Chinese firms reportedly seeking overseas financing are instead headed to European exchanges, namely Zurich and London, where there is no equivocal pressure regarding opening of audit books.²¹⁶ In July of 2022, the Shanghai and Shenzhen exchanges signed a deal

Ltd., MORNINGSTAR (Apr. 19, 2023), <https://www.morningstar.com/stocks/xhkg/00941/dividends>. China Mobile improved its dividend distribution since delisting from the NYSE. *Id.* This suggests the purpose of SOE listing in the United States is to raise capital rather than to maximize shareholder wealth. *Id.*

212. *Cf.* Lamoreaux et. al, *supra* note 59 (finding that foreign SEC registrants with auditors from countries that allow PCAOB oversight enjoy a lower cost of capital, which is amplified for companies that lack other quality corporate governance mechanisms).

213. *See e.g.*, James R. Doty, *The Role of the Audit in Capital Formation*, PCAOB (June 22, 2015), https://pcaobus.org/news-events/speeches/speech-detail/the-role-of-the-audit-in-capital-formation_566.

214. *See* discussion *infra* Sections III. B., C., & D.

215. *See* Hong Kong Stock Exchange Main Board Listing Rules, ch. 1, §1.01, <https://en-rules.hkex.com.hk/rulebook/chapter-19c-secondary-listings-overseas-issuers> [hereinafter HKEx Rules]; *Id.* at ch. 19C, §§ 05, 05A; *China Publishes Rules to Revive Offshore Listings*, REUTERS (Feb. 17, 2023, 10:16 PM), <https://www.reuters.com/markets/deals/china-publishes-offshore-listing-rules-2023-02-17>; *see also* Pei Lei & Filipe Pacheco, *Chinese Share Sales Across Europe Are Likely to Keep Booming in 2023*, BLOOMBERG (Dec. 19, 2022, 6:00 PM), <https://www.bloomberg.com/news/articles/2022-12-20/chinese-share-sales-across-europe-are-likely-to-keep-booming-in-2023?leadSource=verify%20wall>.

216. Filipe Pacheco & Jeanny Yu, *How and Why Chinese Firms Are Listing in Europe Now*, BLOOMBERG QUICKTAKE (Aug. 19, 2021, 12:51 AM), <https://www.bloomberg.com/news/articles/2022-08-19/how-and-why-chinese-firms-are-listing-in-europe-now-quicktake>.

allowing Chinese A-Share companies to carry out secondary listings on the SIX Swiss exchange via a stock connect scheme.²¹⁷ London has had a similar stock connect program with Shanghai since 2019, which may also expand to Shenzhen.²¹⁸ These programs simplify the listing process to facilitate secondary listings by issuing a Global Depository Receipt.²¹⁹ From the beginning of 2022 to September of 2022, five Chinese companies raised more than \$2.1 billion on exchanges in Zurich and London, outweighing the roughly \$400 million raised by Chinese companies in the U.S. during the same period.²²⁰ However, U.S. listings, which typically dwarf that of Europe, were temporarily halted at this time amid the audit dispute and after Chinese regulators forced the delisting of Didi.²²¹ Moreover, the Shanghai-London stock connect program is largely symbolic as very few Chinese firms have actually taken advantage of it since its inception.²²²

Even if some European exchanges may marginally benefit from increased Chinese listings, most Chinese firms that list in Europe are unlikely to have otherwise chosen to list in the United States irrespective of the HFCOA. In contrast to Chinese firms listed in the United States, the overwhelming majority of Chinese firms listing in Europe seek a secondary listing.²²³ Only four China-based firms have a primary listing throughout all of the European exchanges.²²⁴ Additionally, European exchanges often suffer from lower liquidity than the United States.²²⁵ As a result, European exchanges are not a commensurate substitute for U.S. exchanges.

217. Hudson Lockett & Tabby Kinder, *Europe Beat US on Chinese Listings for First Time*, FIN. TIMES (Sept. 7, 2022), <https://www.ft.com/content/f9c5ff9a-635f-4929-b9bc-0a2b2b160098>.

218. *Shenzen, London Vow to Promote Stock Connect, Further Expanding Financing Channels for Enterprises*, GLOB. TIMES (Mar. 1, 2023, 1:08 AM), <https://www.globaltimes.cn/page/202303/1286402.shtml>.

219. Pacheco & Yu, *supra* note 216.

220. Locket & Kinder, *supra* note 217.

221. *Id.*; see Scott Murdoch & Sayantani Ghosh, *Didi's New York Exit a Further Blow to Chinese Listings in U.S.*, REUTERS (Dec. 5, 2021, 8:12 PM), <https://www.reuters.com/markets/us/didis-new-york-exit-further-blow-chinese-listings-us-2021-12-03>.

222. *London Stock Connect*, LONDON STOCK EXCH., <https://www.londonstockexchange.com/discover/china/shanghai-london-stock-connect?tab=stock-connect-issuers> (last visited Mar. 10, 2023).

223. See Pacheco & Yu *supra* note 216; see also Bloomberg Terminal data.

224. See Bloomberg Terminal data.

225. See Pacheco & Yu, *supra* note 216.

B. HONG KONG STOCK EXCHANGE

The Hong Kong Stock Exchange (“HKEx”) has historically had among the most stringent listing requirements in the world, but has been relaxing requirements, making it easier for high growth Chinese tech companies to list.²²⁶ In April of 2018, the HKEx followed Singapore in amending its listing rules to allow companies with weighted voting structures or dual-class shares to seek secondary listings in Hong Kong.²²⁷ Prior to this, many Chinese tech companies such as Alibaba, were unable to list in Hong Kong and sought to list in the United States.²²⁸

After the passage of the HFCAA, the HKEx subsequently altered its rules to make it easier for Chinese to get dual primary listings.²²⁹ Amidst uncertainty around the audit dispute from the HFCAA, many prominent Chinese companies responded to the risk by changing its secondary listing Hong Kong to primary.²³⁰ As of January 9, 2023, thirty-one Chinese companies were listed in both the United States and Hong Kong.²³¹ Of these, just thirteen had secondary listings with the number dwindling as dual-listed companies continue to convert their Hong Kong listings to obtain primary status.²³²

226. See Min Yan, *A Control-Accountability Analysis of Dual Class Share (DCS Structure)*, 45 DEL. J. CORP. L. 1, 40 (2020).

227. See HKEx Rules, *supra* note 215, at ch.1, §1.01; *Id.* at ch. 19C, §§ 05, 05A; see also Thomas J. Egan, Jr. et al., *The Revival of Dual Class Shares*, IFLR1000 (2020), <https://www.bakermckenzie.com/-/media/files/insight/publications/2020/03/the-revival-of-dual-class-shares.pdf>.

228. Egan et al., *supra* note 227.

229. The new rule enables companies with a dual-class structure or variable interest entities to apply for primary listing in Hong Kong where they previously could not. Additionally, it provides routes for secondary listed companies to convert to a primary listing and lifts the requirement that China-based companies are considered “innovative” to apply for a secondary listing. See Shu Du et al., *HKEx Finalizes New Rules on Listings for Overseas Issuers*, SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP (Sept. 14, 2021), <https://www.skadden.com/insights/publications/2021/12/hkex-finalizes-new-rules-on-listings-for-overseas-issuers>; see, e.g., Evelyn Cheng, *Alibaba Gets Hong Kong's Approval for a Primary Stock Listing*, CNBC (Aug. 9, 2022 1:09 AM), <https://www.cnbc.com/2022/08/09/alibaba-gets-hong-kongs-approval-for-a-primary-stock-listing.html>.

230. See U.S-China Economic & Security Review Commission (USCC), *Chinese Companies Listed on Major U.S. Stock Exchanges* (Jan. 9, 2023), https://www.uscc.gov/sites/default/files/2023-01/Chinese_Companies_Listed_on_US_Stock_Exchanges_01_2023.pdf.

231. *Id.*

232. From September 2022 to January 8, 2023, at least three dual-listed companies converted their Hong Kong listing to primary. See USCC, *supra* note 230. In the event one of these companies is delisted from the United States, the new rules would automatically convert to a primary listing in Hong Kong. See Du et al., *supra* note 229.

Due to the problems of U.S. enforcement, cross-listing could be a welcome development to the extent cross-listed firms are subject to enforcement by the Hong Kong Securities and Future Commission and Hong Kong investors.²³³ However, private litigation is rare in Hong Kong, and authorities rely on Chinese cooperation for enforcement.²³⁴ The Hong Kong primary listing allows firms to be included in the Shenzhen-Hong Kong Stock Connect giving mainland Chinese investors access.²³⁵ For the time being, this ironically links U.S. and Chinese investors in ways they previously were not. The Shenzhen-Hong Kong Stock connect, along with the potential pathway for U.S. investors holding ADRs in Chinese companies to convert their shares into corresponding securities listed in Hong Kong further boosts liquidity on the HKEx.²³⁶ This liquidity boost alleviates the harm from delisting from U.S. exchanges.

The imminent effect of the increasing U.S.-Hong Kong cross-listing of Chinese issuers facilitated by HKEx rule changes and HFCAA delisting risk is that it serves to mitigate the detriment to an issuer in the event of being delisted from the United States. At the same time, China is eager to host its most prominent companies on domestic exchanges.²³⁷ The US-Hong Kong cross-listing development enables Chinese regulators to execute this goal by refusing to comply with PCAOB inspections or otherwise forcing delisting while reducing the adverse impact upon the dual-listed company.

233. Fried & Kamar, *supra* note 28, at 37.

234. *See id.* at 38-39.

235. This grants Alibaba reasonable liquidity in the event of delisting. Priyanka Boghani & Umer Khan, *Dual Hong Kong Listings Still Attractive to US-listed Chinese TMT Companies*, S&P GLOBAL (Sep. 23, 2022), <https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/dual-hong-kong-listings-still-attractive-to-us-listed-chinese-tmt-companies-72056065>; Abigail Ng, *Alibaba Pops 6% after Announcing Plans for a Dual Primary Listing in Hong Kong*, CNBC (July 26, 2022), <https://www.cnbc.com/2022/07/26/alibaba-to-apply-for-dual-primary-listing-in-hong-kong-stock-jumps.html>.

236. *See Making Sense of the Sell-Off, Then Rally in Chinese ADRs*, T. ROWE PRICE (Mar. 23, 2022), <https://www.troweprice.com/personal-investing/resources/insights/making-sense-of-the-selloff-then-rally-in-chinese-adrs.html>.

237. *See* Boghani & Khan, *supra* note 235; James T. Areddy, *China to Launch Beijing Stock Exchange to Steer Investment Into Innovation*, WALL ST. J. (Sept. 2, 2021, 6:49 PM), <https://www.wsj.com/articles/china-to-launch-beijing-stock-exchange-to-steer-investment-into-innovation-11630622825>.

C. CHINESE STOCK EXCHANGES

While the HKEx maintains relatively high minimum revenue, net profit, and operating cash flow requirements²³⁸ that many smaller high growth Chinese companies listed in the U.S. may not be able to meet, China is working to facilitate listings of smaller high growth firms in mainland China.²³⁹

For instance, China has instituted reforms designed to fix some of the problems with the approval-based system that is biased against high growth technology companies.²⁴⁰ The STAR Market of Shanghai stock exchange was launched in July of 2019 and the Shenzhen Growth Enterprise Market (“GEM”) board commenced reforms in August of 2020.²⁴¹ The reforms have many features meant to facilitate easier IPOs to high growth technology companies that tend to seek overseas listings. First, firms do not need to get CSRC approval for IPOs.²⁴² Instead, stock exchanges are responsible for ensuring disclosure is adequate.²⁴³ Second, firms do not have to show positive profits to be listed.²⁴⁴ Additionally, dual-class shares and weighted voting rights are allowed.²⁴⁵

Despite the lifting of the profit requirement, apparently only 7% of the 215 STAR IPOs and none of the 63 new GEM IPOs have nonpositive Return on Assets as of August of 2022.²⁴⁶ Therefore, at least so far, the reforms have not caused a significant number of companies to list in China that previously would have had no choice other than to seek an overseas listing. Nonetheless, the registration-based system is also improving the problem of notoriously high underpricing of IPOs, which has imposed high costs for firms to go public in China.²⁴⁷

238. *Rules and Guidance: 8.05*, HKEx, <https://en-rules.hkex.com.hk/rulebook/805-0> (last visited Mar. 10, 2023).

239. See Boghani & Khan, *supra* note 235; see Areddy, *supra* note 237 (discussing proposed Beijing Stock Exchange).

240. See Amir Guluzade, *How Reform Has Made China's State-Owned Enterprises Stronger*, WORLD ECON. F. (May 21, 2020), <https://www.weforum.org/agenda/2020/05/how-reform-has-made-chinas-state-owned-enterprises-stronger>.

241. See Qian et al., *supra* note 42, at 3.

242. *Id.*; see *First Companies Obtain Regulatory Approval for IPOs Under New ChiNext System*, REUTERS (July 13, 2020, 10:54 PM), <https://www.reuters.com/article/uk-china-market-ipo-idUKKCN24F0BV>.

243. Qian et al., *supra* note 42, at 9.

244. *Id.*

245. *Id.*

246. *Id.* at 11.

247. See Yu Ma et al., *IPO Pricing, Investor Behavior, and IPO Underpricing of High-*

China additionally launched its third exchange, the Beijing Stock Exchange on November 15, 2021.²⁴⁸ The exchange is specifically intended to host smaller innovative companies as China looks to host the next generation of technology companies.²⁴⁹ Although most listings are only available to professional investors,²⁵⁰ public listings are increasing. As of the beginning of 2023, 161 Chinese companies had primary listings on the Beijing Stock Exchange.²⁵¹

D. DETERRENCE EFFECT

In order to supplement the qualitative forces supporting an increased deterrence of Chinese companies from listing in the United States, the author gathered data on Chinese and Hong Kong-based firm listings in the United States and domestically dating back to 2010.²⁵² The results indicate that despite an overall increase of Chinese and Hong Kong-based listings on U.S. exchanges since the passage of the HFCAA, these firms have increasingly opted to list their stocks domestically.

Table A displays the data used in each Chart. Chart A shows China and Hong Kong-based listings on U.S. exchanges. Chart B displays the percentage of China and Hong Kong-based firm listings on U.S. exchanges over China and Hong Kong-based firm listings on Chinese and Hong Kong Exchanges. Chart C only differs from Chart B in that it excludes China and Hong Kong-based firms listed on OTC markets. Finally, Chart D shows the percentage of China and Hong Kong-based listings on U.S. exchanges over total U.S. listings.

Tech Companies: Evidence from SSE STAR Market and Nasdaq Market, HINDAWI (Mar. 26, 2022), <https://www.hindawi.com/journals/ddns/2022/1711645>.

248. Sara Hsu, *Introducing the New Beijing Stock Exchange*, THE DIPLOMAT (Nov. 9, 2021), <https://thediplomat.com/2021/11/introducing-the-new-beijing-stock-exchange>.

249. See Areddy, *supra* note 237.

250. *Id.*

251. See Bloomberg Terminal data.

252. See *infra* Table A.

Table A

| | | | | | | | |
|------|---|---|---|--|---|------------------------------------|--|
| Date | China & HK U.S.-based listings ²⁵³ | China & Hong Kong-based domestic exchange listings ²⁵⁴ | % of China & HK-based issuers listed in U.S./ Chinese & HK-based issuers Listed on Domestic Exchanges | China & Hong Kong U.S.-based listings (excluding OTC) ²⁵⁵ | % of China & Hong Kong-based issuers listed in U.S. excluding OTC/ Chinese & Hong Kong-based issuers Listed on Domestic Exchanges | Total U.S. Listings ²⁵⁶ | China & Hong Kong U.S. Listings/ Total U.S. Listings |
|------|---|---|---|--|---|------------------------------------|--|

253. Using the Bloomberg terminal, I set China and Hong Kong as the “country of domicile” and set “exchanges” to the United States in the equity screening function. The exchanges include US-BATS, Cboe BYX Exchange, Cboe BZK Exchange, EDGA, EDGX, FINRA ADF, Investors Exchange, Long Term Stock Exchange, MIAx Pearl, Members Exchange, NASDAQ—CM, GM, GS, Intermarket, OMX BX, OMX PSX—NYSE—Arca, Chicago, American, National—, New York, OTC BB, OTC Markets, OTC US, and Trade Reporting Facility LLC. The securities were additionally screened for the primary security and primary ticker of the company only.

254. Using the Bloomberg terminal, I set China and Hong Kong as the “country of domicile” and set “exchanges” to China in the equity screening function. The exchanges include Beijing Stock Exchange, Shanghai, and Shenzhen. The securities were additionally screened for the primary security and primary ticker of the company only.

255. Using the Bloomberg terminal, I set China and Hong Kong as the “country of domicile” and set “exchanges” to the United States in the equity screening function. The exchanges include US-BATS, Cboe BYX Exchange, Cboe BZK Exchange, EDGA, EDGX, FINRA ADF, Investors Exchange, Long Term Stock Exchange, MIAx Pearl, Members Exchange, NASDAQ—CM, GM, GS, Intermarket, OMX BX, OMX PSX—NYSE—Arca, Chicago, American, National—, New York. The securities were additionally screened for the primary security and primary ticker of the company only.

256. Using the Bloomberg terminal, I set the “country of domicile” and “exchanges” to the United States in the equity screening function. The exchanges include US-BATS, Cboe BYX Exchange, Cboe BZK Exchange, EDGA, EDGX, FINRA ADF, Investors Exchange, Long Term Stock Exchange, MIAx Pearl, Members Exchange, NASDAQ—CM, GM, GS, Intermarket, OMX BX, OMX PSX—NYSE—Arca, Chicago, American, National—, New York, OTC BB, OTC Markets, OTC US, and Trade Reporting Facility LLC. The securities were additionally screened for the primary security and primary ticker of the company only.

| | | | | | | | |
|--------|-----|------|-------------|-----|------------|-------|-------------|
| 1/4/10 | 172 | 3004 | 0.057256991 | 172 | 0.05725699 | 5286 | 0.032538782 |
| 6/1/10 | 191 | 3173 | 0.060195399 | 190 | 0.05988024 | 5266 | 0.036270414 |
| 1/3/11 | 552 | 3435 | 0.16069869 | 229 | 0.06666667 | 15087 | 0.036587791 |
| 6/1/11 | 567 | 3605 | 0.157281553 | 236 | 0.06546463 | 15145 | 0.037438098 |
| 1/3/12 | 566 | 3866 | 0.146404553 | 208 | 0.05380238 | 14901 | 0.037984028 |
| 6/1/12 | 561 | 3962 | 0.141595154 | 194 | 0.04896517 | 14966 | 0.037484966 |
| 1/2/13 | 547 | 4130 | 0.132445521 | 177 | 0.04285714 | 14743 | 0.037102354 |
| 6/3/13 | 533 | 4204 | 0.126784015 | 170 | 0.04043768 | 14671 | 0.036330175 |
| 1/2/14 | 509 | 4316 | 0.117933272 | 168 | 0.03892493 | 14597 | 0.034870179 |
| 6/2/14 | 507 | 4387 | 0.115568726 | 167 | 0.03806702 | 14372 | 0.035276927 |
| 1/2/15 | 485 | 4554 | 0.10649978 | 161 | 0.03535354 | 14334 | 0.033835636 |
| 6/1/15 | 489 | 4767 | 0.102580239 | 162 | 0.03398364 | 14384 | 0.033996107 |
| 1/4/16 | 481 | 4965 | 0.096878147 | 160 | 0.03222558 | 14406 | 0.033388866 |
| 6/1/16 | 461 | 5071 | 0.090909091 | 146 | 0.02879117 | 14029 | 0.032860503 |
| 1/3/17 | 446 | 5375 | 0.082976744 | 140 | 0.02604651 | 13758 | 0.032417503 |
| 6/1/17 | 440 | 5676 | 0.07751938 | 136 | 0.02396054 | 16403 | 0.026824361 |
| 1/2/18 | 450 | 5989 | 0.075137753 | 152 | 0.02537986 | 16229 | 0.027728141 |
| 6/1/18 | 457 | 6138 | 0.07445422 | 164 | 0.0267188 | 16166 | 0.028269207 |
| 1/2/19 | 482 | 6289 | 0.076641755 | 186 | 0.02957545 | 16053 | 0.03002554 |
| 6/3/19 | 492 | 6413 | 0.076719164 | 201 | 0.03134259 | 15907 | 0.030929779 |
| 1/2/20 | 497 | 6682 | 0.07438928 | 216 | 0.03232565 | 15710 | 0.031635901 |
| 6/1/20 | 505 | 6873 | 0.07347592 | 222 | 0.03230031 | 15552 | 0.032471708 |
| 1/4/21 | 516 | 7269 | 0.070986381 | 239 | 0.03287935 | 15640 | 0.032992327 |
| 6/1/21 | 536 | 7618 | 0.070359674 | 264 | 0.03465477 | 16057 | 0.03338108 |
| 1/3/22 | 542 | 8120 | 0.066748768 | 278 | 0.03423645 | 16456 | 0.032936315 |
| 6/1/22 | 540 | 8373 | 0.064493013 | 273 | 0.0326048 | 16527 | 0.032673806 |
| 1/3/23 | 524 | 8653 | 0.060557032 | 269 | 0.03108748 | 16163 | 0.032419724 |

Chart A

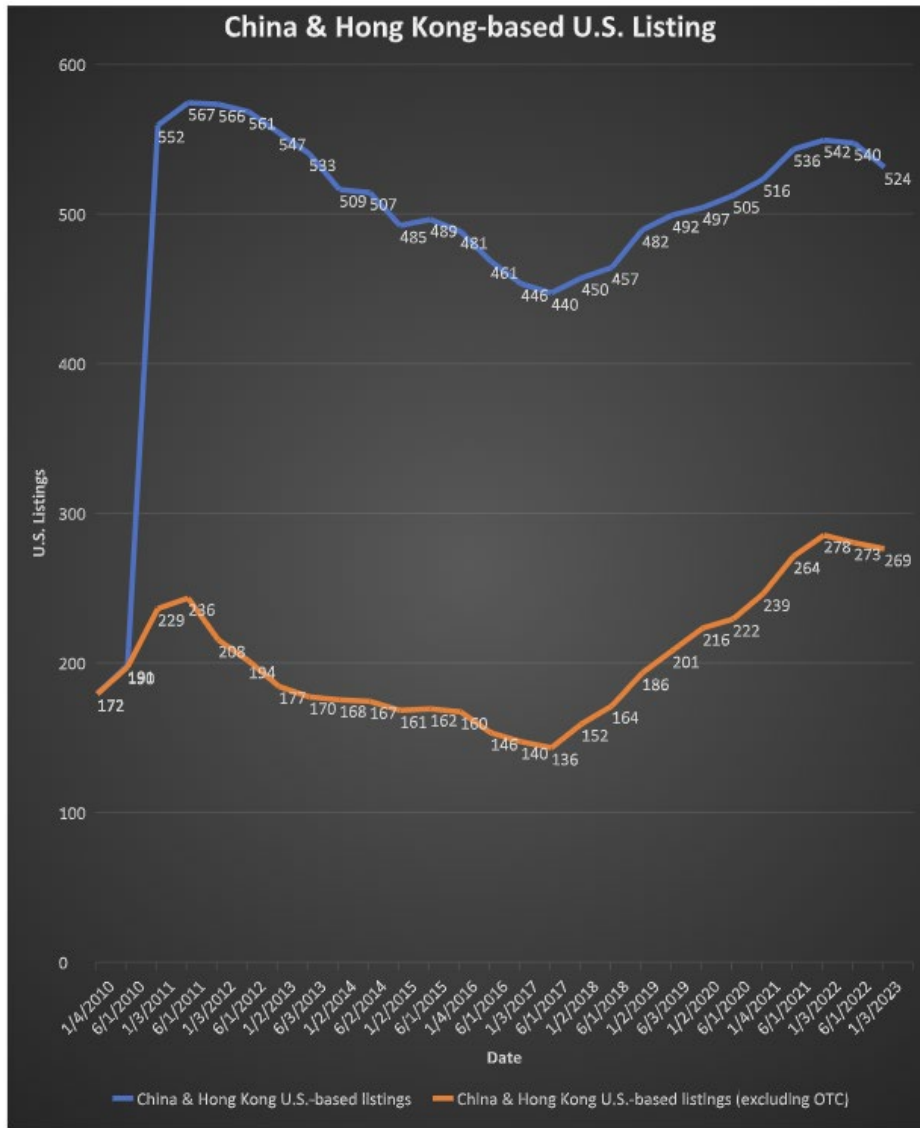


Chart B

China & Hong Kong-based Firms U.S. Listings/ Domestic Listings

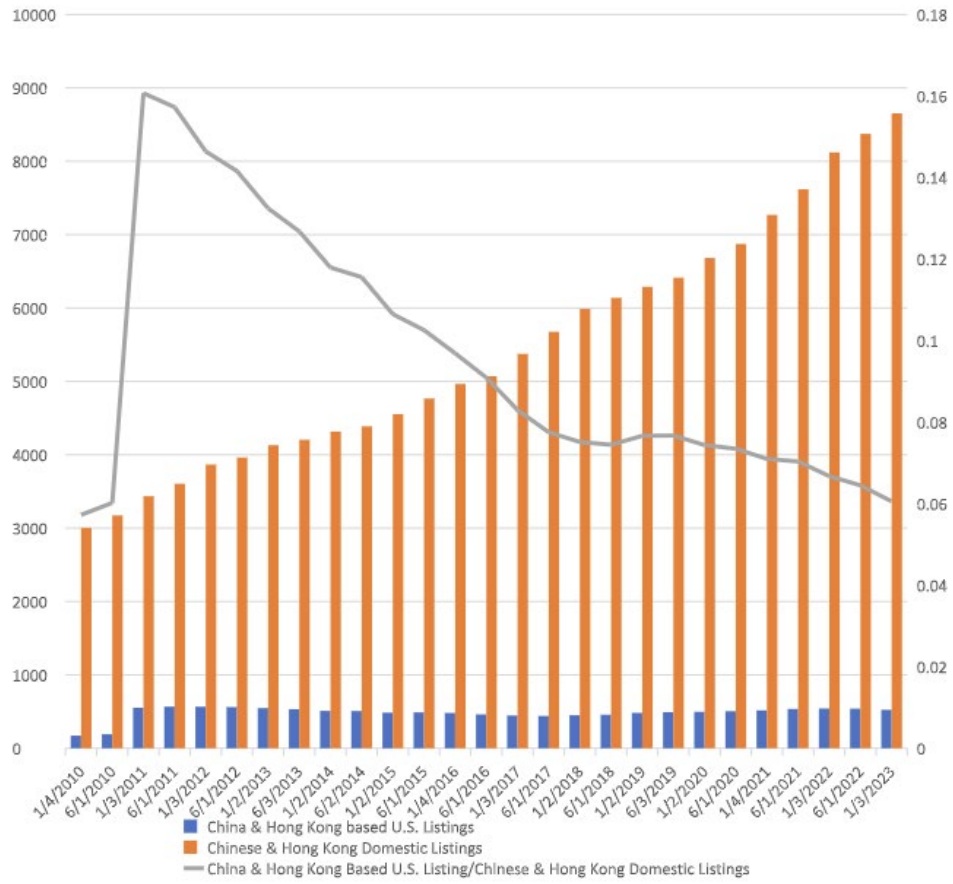


Chart C

China & Hong Kong-based Firms U.S. Listings/ Domestic Listings: No OTC Listings

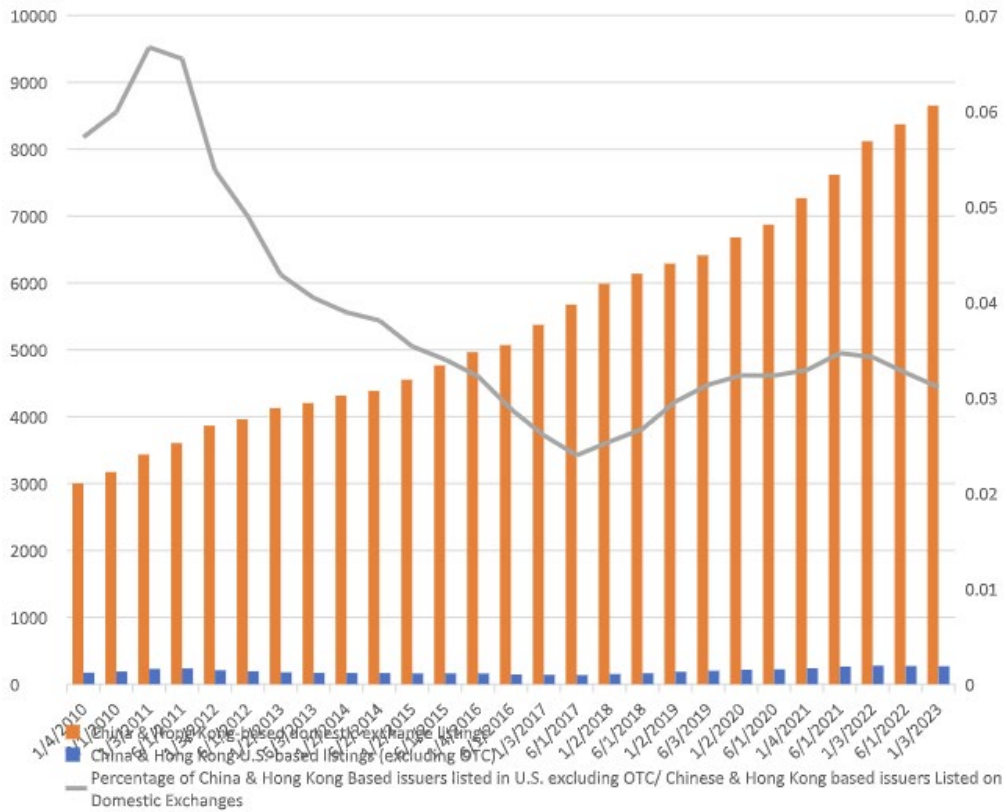
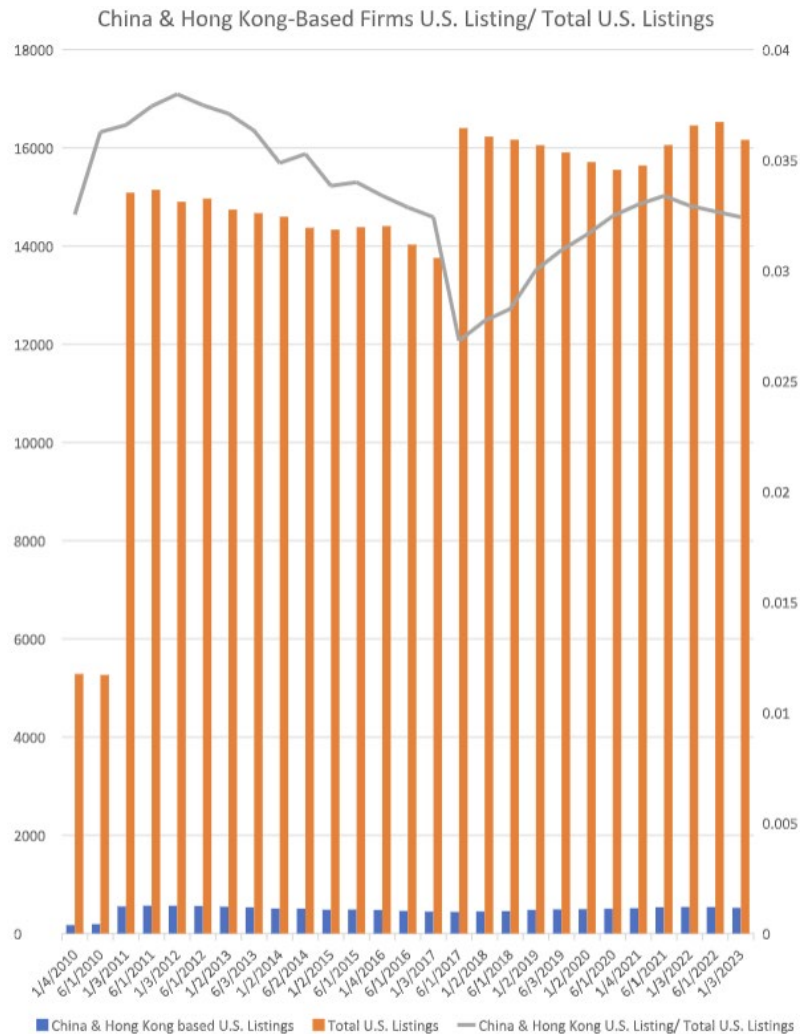


Chart D



Notably, Chart A most clearly displays a momentous spike in listings from 2010 to 2011 with an ensuing downward trend from 2011 to 2017. This spike can be attributed to the wave of reverse merger firms.²⁵⁷ The following downward trend in China and Hong Kong listings on U.S. exchanges corresponds with the fact that many of these firms were delisted and the U.S. closed the reverse merger

257. See *supra* notes 30–33.

loophole.²⁵⁸ Putting the reverse merger anomaly aside, Chart A largely reveals a continuation of China and Hong Kong-based listings on U.S. exchanges for a full year after the HFCAA was passed. However, this trend began to reverse more recently in 2022, with the aggregate number of China and Hong Kong-based U.S. listings decreasing for the first time since 2017. Even so, the net listing of Chinese and Hong Kong issuers in the U.S. needs to be compared to the total listings of Chinese issuers in the Chinese domestic market in order to discern the proportion of all China-based issuers listed in the U.S.

Accordingly, Chart B and C illustrate the most important findings. As both Charts indicate, there is a noticeable drop in the percentage of China-based U.S. listings as a function of Chinese domestic listings beginning after the passage of the HFCAA on December 18, 2020. This trend is even more pronounced when including firms listed on OTC exchanges, as Chart B displays.²⁵⁹ However, this can more likely be attributed to an SEC rule designed to strengthen OTC market requirements and crackdown on participants, rather than the HFCAA.²⁶⁰ In any case, a higher proportion of Chinese firms chose to list domestically, rather than in the United States, since the passage of the HFCAA irrespective of the inclusion of OTC markets.

Chart D compares China and Hong Kong firm listings on U.S. exchanges to overall U.S. exchanges. First, the results show Chinese and Hong Kong firms make up a slightly lower proportion of total U.S. listings since the passage of the HFCAA. Second, Chart D shows overall U.S. listings have slightly increased since the passage of the HFCAA. This is notable because it demonstrates that the trend of Chinese and Hong Kong firms increasingly opting to list domestically cannot be attributed to a decrease in overall listings on U.S. exchanges since the HFCAA was passed.

The trend of Chinese and Hong Kong-based firms increasingly listing domestically rather than in the United States may be tainted by its overlap with a heightened risk of delisting during the period of

258. *Id.*

259. Recall, the HFCAA trading prohibition includes a prohibition on trading in OTC markets, which often feature lower quality and more fraud-prone firms. Without regard to the HFCAA, a firm that is delisted from the NYSE or Nasdaq, such as Luckin Coffee, could still trade on OTC markets. *SEC Adopts Amendments to Enhance Retail Investor Protections and Modernize the Rule Governing Quotations for Over-the-Counter Securities*, SEC. & EXCH. COMM'N (Sept. 16, 2020), <https://www.sec.gov/news/press-release/2020-212>.

260. *Id.*; Michael Price & John Mccrank, *U.S. 'Pink Sheets' in Shakeup as Securities Regulator Looks to Stamp out Fraud*, REUTERS (Sept. 23, 2021), <https://www.reuters.com/business/finance/us-pink-sheets-shakeup-securities-regulator-looks-stamp-out-fraud-2021-09-23/>.

uncertainty as to whether China would allow the PCAOB the access it demanded.²⁶¹ One may intuitively speculate that the heightened risk of delisting temporarily and disproportionately deterred Chinese companies from listing in the United States. However, such intuition is likely misguided. First, compliance with the PCAOB oversight remains a risk, nonetheless.²⁶² Second, it is also possible that Chinese firms rushed to list in the U.S. immediately after the passage of the HFCAA under the assumption that they would later benefit from a delisting by facilitating a cheap freeze out transaction.²⁶³ As a matter of fact, while China and Hong Kong-based firms' U.S. listings increased immediately after the passage of the HFCAA, they substantially dropped as it became more probable the PCAOB would be granted access and the corresponding risk of being delisted was reduced.²⁶⁴

Regardless, the increased control of Chinese regulators over firms and developments of Chinese exchanges supports a continuation of Hong Kong and Chinese firms increasingly opting to list domestically. Chinese firms may no longer bypass CSRC approval via a variable interest entity when listing in the United States.²⁶⁵ Collectively, the listings on the freshly created STAR Market, GEM Board, and the Beijing Stock Exchange explain a substantial portion of the relative increase in Chinese domestic listings in relation to U.S. listings.²⁶⁶

The resulting trend in listings may also be more sustainable than the deterrence of foreign listing in the U.S. after the passage of SOX.²⁶⁷ Unlike SOX, other countries appear unlikely to adopt legislation similar to the HFCAA. Many countries followed the U.S. in issuing similar laws to SOX to protect investors and guard against financial scandals.²⁶⁸ Thus, it eventually became difficult for a foreign issuer to

261. Evelyn Cheng, *Delisting Risk for U.S.-Listed Chinese Stocks Nearly Halves After Regulators Reach Audit Agreement, Goldman Says*, CNBC (Aug. 28, 2022), <https://www.cnbc.com/2022/08/29/goldman-us-delisting-risk-for-chinese-adr-stocks-halves-after-deal.html>.

262. *See id.*; *see also supra* Section II.C.

263. *See* Fried & Kamar *supra* note 28, at 23–24.

264. *See* Table A & Chart A.

265. *See supra* note 167–68 and accompanying text.

266. *See supra* Section III.C.

267. Although the evidence is mixed, it appears SOX at least initially had a negative effect on companies listing in the United States. *See* Joseph D. Piotroski & Suraj Srinivasan, *Regulation and Bonding: The Sarbanes-Oxley Act and the Flow of International Listings*, 46 J. ACCT. RSCH. 383 (2008); *see also* Soo-Jeong Shin, *The Effect of the Sarbanes-Oxley Act of 2002 on Foreign Issuers Listed on the U.S. Capital Markets*, 3 N.Y.U. J.L. BUS. 701 (2007); Christopher Woo, *United States Regulation and FPIs: Lessons from the Sarbanes-Oxley Act*, 48 AM. BUS. L.J. 119 (2011).

268. Ethiopis Tafara, *A Race to the Top: International Regulatory Reform Post*

avoid the burden of increased costs of compliance with securities regulations while maintaining commensurate benefits. As a result, any adverse impact on foreign listings due to the more stringent requirements of SOX may have been mitigated by triggering a race to the top. Conversely, other countries are unlikely to correspondingly adopt specific measures similar to the HFCAA. Conversely, the HFCAA is principally influenced by the goal of deterring Chinese companies, which can be largely attributed to attitudes of hegemonic competition unique to the United States and China.

IV. CONCLUSION

While PCAOB oversight of Chinese auditors is a welcome step for U.S. investors, the HFCAA only addresses a sliver of the overarching issues with Chinese firms listed in the United States.²⁶⁹ Policymakers should consider imposing Form 4 reporting requirements on Chinese Issuers to better protect U.S. investors.²⁷⁰ Surely, this would likely lead to additional deterrence of Chinese companies from listing on U.S. exchanges. However, this deterrence would more directly benefit U.S. investors.²⁷¹

Yet, the HFCAA is only partially about protecting U.S. investors in the first place. Rather, it is a policy objective designed to identify and punish Chinese companies with ties to the Chinese government and military by banning them from trading on U.S. exchanges. On one hand, the Act may be effective in achieving those initiatives. The most conspicuous Chinese SOEs have already delisted from U.S. exchanges.²⁷² Moreover, the HFCAA is likely to aid in identifying and banning securities transactions of Chinese Military Companies in the U.S. as national security tensions between the two countries continue

Sarbanes-Oxley, U.S. SEC. & EXCH. COMM'N (Sept. 2006), <https://www.sec.gov/news/speech/2006/spch091106et.htm>; Jidong Zhang & Jing Han, *Adoption of Sarbanes-Oxley Act in China: Antecedents and Consequences of Separate Auditing*, 20 INT'L J. AUDITING 108 (2016) (providing an overview of foreign country's SOX equivalents and detailing China's adoption of the Enterprise Internal Control Standard); Shin, *supra* note 267, at 736 (explaining the European Union, Canada, and South Korea adopted reforms in securities regulations that closely mirrored SOX or made movements towards a system resembling U.S. Corporate governance).

269. *See supra* Section I.C & I.D.

270. *See supra* Section I.D.

271. *See supra* Section I.D. This is because deterrence resulting from an imposition of Form 4 reporting requirements will be concentrated at those companies who wish to maximize the private benefits of control because it subjects those companies to increased public scrutiny. *Compare supra* Section I.B, with *supra* Section I.D.

272. *See supra* notes 207–209.

to rise.²⁷³

This note demonstrates that the HFCAA has precipitated a deterrent force beyond the mere delisting of Chinese SOEs. A substantially higher proportion of all Chinese firms have been listed domestically since the passage of the HFCAA. This trend, displayed in Charts B & C, is likely to continue as China positions itself to host Chinese companies on domestic exchanges. Chinese exchanges are fixing problems that either forced or incentivized Chinese firms to look elsewhere. The Hong Kong Stock Exchange is facilitating dual primary listings of China-based firms listed in the United States, quelling the detriment of potential delisting from U.S. exchanges.²⁷⁴ Moreover, Chinese regulators have increased their gatekeeping authority over PCAOB audit access and overseas listing destinations of Chinese firms.²⁷⁵ As China positions itself to execute its goal of hosting its most prominent companies on domestic exchanges, policymakers ought to question whether such deterrence actually benefits the objectives of the Chinese government.

273. *See supra* Section II.D.

274. *See supra* Section III.B.

275. *See supra* Section II.C.