The Future of China's U.S.-Listed Firms: Legal and Political Perspectives on Possible Decoupling

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THE FUTURE OF CHINA’S U.S.-LISTED FIRMS: LEGAL AND POLITICAL PERSPECTIVES ON POSSIBLE DECOUPLING

REBECCA PARRY & QINGXIU BU*

ABSTRACT

There is a long history of Chinese firms raising capital on leading U.S. exchanges. These shares have proved attractive and are estimated at $1 trillion value, in spite of deep mismatches between Chinese internal approaches to corporate governance and those taken under U.S. securities regulations. Chinese listings of nonstate firms, particularly in the technology sector, had depended on a largely laissez-faire initial approach to the expansion through foreign listings, including tolerance of the opaque Variable Interest Entity (VIE) structures adopted as a means to bypass Chinese restrictions on foreign ownership. Concerns regarding data security had, however, prevented compliance by Chinese firms listed in the United States with audit inspection requirements, and these mismatches in the United States have now led to Chinese firms being on shaky ground on both sides of the U.S.-China fault-line. U.S.-listed Chinese companies have faced the looming threat of delisting under the Holding Foreign Companies Accountable Act (HFCAA), enacted in response to both non-compliance with audit inspection requirements and concerns about the opaque nature of VIEs and possibilities of Chinese state control. Admittedly, fears of mass delistings under the HFCAA in the near future have been allayed by Chinese agreement as to U.S. audit inspections, and the 2022 finding of two Chinese firms to be compliant with U.S. regulations. There remains, however, heightened levels of Chinese state involvement in the affairs of nonstate companies with further potential to bring strain, as Communist Party policies have changed.

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dramatically in recent years, alongside heightened geopolitical tensions. The data concerns that had prevented audit inspections have not disappeared and, in fact, have grown. These, together with some other harmful Chinese state strategies impressed upon nonstate firms and preferences for Chinese firms to look inwards for capital, as well as a damaging trade war in semiconductors, present remaining concerns regarding investments in U.S.-listed Chinese firms. Immediate concerns regarding delistings under the HFCAA may have abated but there may be other firms for which compliance may be difficult, and there remains potential for future delistings, presenting risks for U.S. investors. These Chinese firms may find the exit voluntarily whilst the stream of U.S. listings by Chinese companies will slow. It will not yet amount to a decoupling, but investors should be wary.
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INTRODUCTION

Chinese firms have long been attracted to listing on the major U.S. exchanges as an alternative to the more rigid and protracted listing processes in China.¹ As of March 2022, there were 261 such Chinese companies, with a total market capitalization of $1.3 trillion.² Yet these firms have long benefited from U.S. capital without complying with investor protections, particularly audit inspections, owing to sensitivities around company data.³ Consequently, in December 2022, 174 of these listings, including those of some of China’s largest nonstate firms, were identified as at risk of delisting due to the Holding Foreign Companies Accountable Act (HFCAA).⁴ The political climate has also changed for these firms within China.⁵ An initially laissez-faire approach by China to the expansion of nonstate firms led to U.S. listings, which also exposed investors to uncertainties through the use of Variable Interest Entity (VIE) structures to bypass controls on ownership of foreign companies.⁶ VIEs obscure what interest investors have in U.S.-listed Chinese firms, and this remains a problem for U.S. investors who may not know what they are investing in, alongside

¹ Cinder Xinde Zhang & Tao-Hsien Dolly King, The Decision to List Abroad: The Case of ADRs and Foreign IPOs by Chinese Companies, 20 J. MULTI. FIN. MANAG. 71, 72, 75 (2010).
³ Zhang & King, supra note 1, at 72.
risks to Chinese investments presented by state interference, concerns that are also addressed under the HFCAA.\textsuperscript{7}

The HFCAA was enacted in the face of Chinese resistance to the audit inspections required under the Sarbanes-Oxley Act.\textsuperscript{8} The lack of audit inspections potentially conceals financial problems, as in the Luckin Coffee accounting fraud, where misleading statements about profits caused significant losses for U.S. investors.\textsuperscript{9} More recently, there have been encouraging developments through agreements that can be regarded as compromises on the part of Chinese regulators. One example of such an agreement is the Statement of Protocol permitting audit inspections of Chinese and Hong Kong firms, signed in August 2022.\textsuperscript{10} The response by U.S. regulators to this agreement “on paper” was guarded, and a need for unfettered access has been emphasized.\textsuperscript{11} Any failure to comply would have put listings of some major Chinese companies


\textsuperscript{8} Id. There were other countries which also had resisted audit inspections but only China and Hong Kong remain. Belgium has entered into a cooperative protocol to enable inspection. See \textit{PACOB Enters Into Cooperative Agreement with Belgian Audit Regulator}, PUB. CO. ACCT. OVERSIGHT BD. (Apr. 20, 2021), https://pcaobus.org/news-events/news-releases/news-release-detail/pcaoenters-into-cooperative-agreement-with-belgian-audit-regulator [https://perma.cc/2546-AU36]. In a news release, the Public Company Accounting Oversight Board in the United States announced that France also has agreed to a Statement of Protocol between the Haut Conseil du Commissariat aux Comptes in France and the Public Company Accounting Oversight Board in the United States of America. \textit{PACOB Renews Cooperative Agreement with French Audit Regulator}, PUB. CO. ACCT. OVERSIGHT BD. (Apr. 9, 2021), https://pcaobus.org/news-events/news-releases/news-release-detail/pcao-renews-cooperative-agreement-with-french-audit-regulator [https://perma.cc/NF7C-J2KV].

\textsuperscript{9} The company overstated its annual sales figure by $300 million in its 2019 Annual Report, causing significant losses to U.S. investors. See Zhe Peng et al., \textit{The Luckin Coffee Scandal and Short Selling Attacks}, 34 J. BEHAV. EXP. FIN. 1, 1–2 (2022) (explaining the significance of the scandal to Chinese firms seeking to list in the United States).


\textsuperscript{11} Id.
at risk, including some giants in the online platform sector.\footnote{12} Therefore, it may be regarded as an important concession that two U.K.-affiliated firms permitted the audit inspections of 200 Chinese firms in the last months of 2022, resulting in two 2021 determinations of non-compliance being vacated.\footnote{13} Whilst these were positive developments, the long-term prospects under the HFCAA depend on compliance by other audit firms, as well as continued compliance by the two firms involved in the initial inspection, and there are other risks that must be considered.\footnote{14} Delistings of firms in this sector have already been augured by that of Didi Chuxing, a delisting followed an investigation by the Cyberspace Administration of China (CAC),\footnote{15} and, prior to that, Luckin Coffee.\footnote{16} Forced delisting under the HFCAA would be a further blow for firms in this sector, which have been the subject of frequent regulatory skirmishes in recent months and have lost value as a result.\footnote{17} It is likely that voluntary listing in alternative markets will be preferred to U.S. listings for some, with several firms already developing plans for voluntary delisting.\footnote{18}

\footnote{12} This Article uses the term “online platform” broadly to identify firms which offer services primarily online, following the OECD definition. See \textit{What is an “Online Platform”?}, in \textit{An Introduction to Online Platforms and Their Role in the Digital Transformation}, 19–20 (2019).


\footnote{15} Although its contentious IPO was in June 2021, it was not until May 2022 that Didi shareholders voted to delist. Ryan McMorrow, \textit{Didi Investors Vote to Delist in US in Bid to Revive China Business}, FIN. TIMES (May 23, 2022), https://www.ft.com/content/0ea2b194-3575-4b7b-9a61-521abdbb1602 [https://perma.cc/BFV6-WKKU].

\footnote{16} See Peng et al., \textit{supra} note 9, at 1–2.

\footnote{17} Emma Lee, \textit{Top 5 Chinese Tech Firms Have Lost Nearly Half of Combined Market Cap in 2 Years}, TECHNODE (May 9, 2022), https://technode.com/2022/05/09/top-5-chinese-tech-firms-have-lost-nearly-half-of-combined-market-cap-in-2-years/ [https://perma.cc/PX3R-VHNA].

The risks presented by restrictions on audit inspections might have abated, but the Didi Chuxing delisting hints at other risks arising in the context of Chinese politics, including the wider United States and China rivalry as each vies for supremacy and geopolitical influence.\textsuperscript{19} Differing ideologies and approaches to state involvement in nonstate businesses initially did not cause significant problems, due to low political and regulatory tension, but more recently they have led to tensions in initial public offerings (IPOs), tariffs and other sanctions,\textsuperscript{20} and even predictions of financial decoupling.\textsuperscript{21} China has also been taking dramatic steps to safeguard its data security\textsuperscript{22} in the face of the Edward Snowden leaks regarding U.S. surveillance.\textsuperscript{23} A Chinese desire to be less reliant on foreign capital has also been influential, and there are
signs that China is looking within for future funding of innovation, as well as striving to end problematic reliance on foreign innovation, particularly in semiconductors. This latter issue is potentially of greatest concern as punitive U.S. curbs on supply that disrupt wider international semiconductor supply chains put the long-term prosperity of many Chinese firms at risk.

This Article proceeds in four parts. It begins in Part I with the Chinese angle as, although the focus is on U.S. exchanges, the Chinese political context is important to U.S. listings. It outlines the Chinese political context, the rise of nonstate firms and their reasons for listing in the United States. It shows how China’s initial laissez-faire approach to foreign listings led to Chinese firms’ expansion but later gave rise to concerns and striking assertions of Chinese Communist Party (CCP) values. Part II examines the fears of espionage and concerns around data security that are at the heart of many of the difficulties faced by Chinese companies with U.S. listings. Part III considers the U.S. perspective and the efforts made to improve investor protection with the HFCAA, the Chinese response to it in the recently agreed-upon Statement of Protocol and the successful inspections of two firms. Part IV considers broader implications and highlights that the HFCAA is not the only factor leading to possible delistings.


27 See infra Part I.
28 See infra Part I.
29 See infra Part I.
30 See infra Part II.
31 See infra Part III.
32 See infra Part IV.
will be noted but with the overall pattern falling short of near-future decoupling.\textsuperscript{33}

I. PARTY-STATE CAPITALISM AND ITS IMPACT ON U.S.-LISTED CHINESE FIRMS

Investments in Chinese companies listed in the United States are at risk against a background of reassertion of CCP policies in the CCP’s hundredth year, alongside U.S.-China rivalries.\textsuperscript{34} Levels of Chinese state involvement in the market have varied across the decades following China’s planned economy phase, with the current phase being heightened markedly through assertion of CCP policies.\textsuperscript{35} Going back to the initial years of its reform and opening-up phase, starting in 1978, the CCP focused on political and ideological concerns and ceded regulatory authority to the government organ, the State Council.\textsuperscript{36} More recently, however, the role of the CCP, rather than the State Council, has been growing through greater involvement in the economy, with resulting impacts on nonstate firms.\textsuperscript{37} There has been increased regulation of data security,\textsuperscript{38} monopolies and “disorderly expansion of capital,”\textsuperscript{39} and rules regarding foreign listings.\textsuperscript{40} Rather

\textsuperscript{33} See \textit{infra} Part IV.
\textsuperscript{34} See \textit{Margaret Pearson et al., Party-State Capitalism in China,} 120 \textit{CURREN T HIST.} 207, 207–08 (2021) [hereinafter \textit{Pearson et al., Party-State Capitalism}].
\textsuperscript{35} Id.
\textsuperscript{40} On December 24, 2021, the China Securities Regulatory Commission announced the planned revision of the Special Provisions of the State Council Concerning the Overseas Securities Offering and Listing by Limited Stock Companies (No. 160 Order of the State Council), and the formulation of the Draft Provisions of the State Council on the Administration of Overseas Securities
than corporate governance failures being addressed through macroprudential hard and soft regulatory measures, they have been the subject of prosecutions, anti-corruption incarcerations of state and private actors, and nationalizations. It has perceptively been noted that this more recent Chinese approach represents a “sui generis form of political economy in which the party-state’s political survival trumps developmental goals,” termed “party-state capitalism.”

There have been numerous examples of actions taken to promote the longevity of the CCP’s social model, even though this can be economically harmful, including interventions on grounds of common prosperity that have damaged share prices of Chinese companies in the sectors affected, and the bold dynamic “zero COVID” approach that softened only in December 2022 following protests.

From an external perspective, China has discovered the difficulties in an international context of its “bird and a cage” approach, in which the market acts as a free-flying bird within the constraints of CCP strategies. Nonstate firms have been seen to give rise to upstart entrepreneurs, contribute to a housing bubble, 


41 Margaret M. Pearson et al., China’s Party-State Capitalism and International Backlash: From Interdependence to Insecurity, 47 INT’L. SEC. 135, 145–46 (2022) [hereinafter Pearson et al., International Backlash].

42 Pearson et al., Party-State Capitalism, supra note 34, at 207 (emphasis added).

43 Lee, supra note 17.


45 The approach is that of Chen Yun, although the approach was implemented during the time of Deng Xiaopeng’s leadership. David Bachman, Differing Visions of China’s Post-Mao Economy: The Ideas of Chen Yun, Deng Xiaoping, and Zhao Ziyang, 26 ASIAN SURV. 292, 297 (1986).


47 Zhang Jing (张竞), Xi Jinping fànhái: Fángzǐ shì yòng lái zhū de, bùshì yòng lái chǎo de! (习近平发话了：房子是用来住的，不是用来炒的!) [Xi Jinping Has Spoken: Houses Are for Living in, Not for Speculation!] (搜狐) [Sohu]
stoke inequalities in education,

and CCP policies of common prosperity were reasserted, damaging share values.
The growth of nonstate firms also highlighted limits to what can be achieved through market intervention in cases where there are foreign listings, as here state party capitalism runs into different political models, market regulations, and investor protections which may be perceived as threats to national security.

There are ambitions, discussed in Part IV, to build from within, with Chinese capital and Chinese technology that are likely to be influential yet potentially built on a fragile foundation of dependence on foreign semiconductors.

This Section first outlines the reasons why many Chinese companies have elected to list in the United States and then considers how the Chinese political context of approaches to the nonstate sector, including those listed on U.S. exchanges, has been damaging.

A. Reasons for Listings on U.S. Exchanges

A laissez-faire approach to the nonstate sector in the years following China’s accession to the World Trade Organization in

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50 See, for example, the discussion below of China’s Cybersecurity Review Measures 2021. Infra Section II.A.1.

51 See infra note 308 and accompanying text.
2001 enabled many Chinese firms to enjoy rapid growth, including through U.S. listings.\textsuperscript{52} The attraction of IPOs on foreign exchanges such as the New York Stock Exchange (NYSE) included the possibility of both higher valuations\textsuperscript{53} than could be achieved through domestic listings and a large global institutional investor base.\textsuperscript{54} It has been estimated that there is a valuation premium of nearly forty percent associated with cross-listing on the U.S. stock exchanges.\textsuperscript{55} Greater political freedom has also been identified as lowering the cost of capital.\textsuperscript{56} China’s increased move to a market-based system has not been accompanied by political liberalization, bringing non-transparent processes with a political element to decision making, which increases political and regulatory risk,\textsuperscript{57} and this inevitably raises the cost of capital.\textsuperscript{58} More intervention minimizes liquidity and increases market volatility.\textsuperscript{59} In contrast, the liberal regime of the United States and its lighter level of regulation has rendered it a magnet for Chinese IPOs, despite rising political, trade, and regulatory tensions between the two powers.\textsuperscript{60}

\textsuperscript{52} 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, 1823 (2002).

\textsuperscript{53} Id. at 1831.


\textsuperscript{56} Yaxuan Qi et al., Political Rights and the Cost of Debt, 95 J. FIN. ECON. 202, 222 (2010).


In March 2022, there were 261 Chinese companies listed on the major U.S. exchanges, the NYSE, National Association of Securities Dealers Automated Quotations Stock Market (NASDAQ), and NYSE American, exchanges with a total market capitalization of $1.3 trillion, an increased number of such listings, although the level of capitalizations was down from record investment levels in 2021. Share prices have been impacted by China’s tightened control over cross-border data transfer and the Securities and Exchange Commission’s (SEC) escalated surveillance of Chinese IPOs, and this activity in both jurisdictions may have influenced an absence of new listings of Chinese firms on the three major U.S. exchanges between mid-July 2021 and the end of October 2021. As noted, the looming threat of the HFCAA has abated somewhat as an agreement regarding audit inspections has been reached, and there have been two successful inspections of audit firms, but continued compliance will be important. This Article focuses on the impacts on the nonstate sector, highlighting the impact of state policies on such firms, although a small number of Chinese state-owned enterprises (SOEs) have listed on U.S. exchanges and may prefer to delist voluntarily.
B. The Rise of Private Companies

The strength of the nonstate sector is reflected in the popular number combination of 60/70/80/90. These numbers describe how nonstate firms “contribute 60% of China’s [gross domestic product], and are responsible for 70% of innovation, 80% of urban employment and 90% of new jobs.” As the “innovation” component of this concept highlights, nonstate market players have been better adapted to the technology sector than SOEs and the nonstate sector has therefore played an important role, with some nonstate market players acting as “national champions” in the pursuit of China’s technological ambitions. Priorities are in high-end areas of technology such as semiconductors, artificial intelligence (AI), and biotech, in pursuit of CCP policies towards competitive advantage in these areas, as well as to improve methods in existing manufacturing processes using domestically much better shape, including supply-side reforms, consolidations, and an ambitious approach to close down zombie companies. Id. Those that listed in the United States, most of which are likely to delist voluntarily, are China Petrochemical Corporation, Sinopec Shanghai Petrochemical Co Ltd, China Life Assurance Co Ltd, PetroChina Co Ltd, Huaneng Power International Inc., China Southern Airlines, China Eastern Airlines, Aluminum Corporation of China. Lulu Yilun Chen & John Cheng, China State-Owned Giants to Delist from US Exchanges Amid Audit Spat, BUS. STANDARD (Aug. 13, 2022, 1:20 AM), https://www.business-standard.com/article/international/china-state-owned-giants-to-delist-from-us-exchanges-amid-audit-spat-122081200874_1.html [https://perma.cc/72Z6-2MLZ].


68 Id.


developed technologies\textsuperscript{71} and there have been strategic investments in nonstate companies in these areas, as well as a preference for these prestige firms to list domestically on the Shanghai or Shenzhen exchanges, rather than in the United States.\textsuperscript{72}

Not all nonstate companies have been shown favor, however; after years of a more laissez-faire approach, China has used state power to discipline nonstate companies, many of which are online platform businesses.\textsuperscript{73} Platform firms have enjoyed success thanks to state investment in good Internet and mobile communications, a large population, relatively weak controls on personal data usage and a lack of penetration from international platforms.\textsuperscript{74} These firms attract headlines as they are some of China’s biggest companies and China has cracked down on this sector over fears that their “disorderly expansion of capital” can lead to monopolies and a position that can be exploited to manipulate public opinion,\textsuperscript{75} and undermine “common prosperity.”\textsuperscript{76}

\textsuperscript{71} Reflected in a statement of Premier Li Keqiang at a symposium of the Ministry of Industry and Information Technology, June 15, 2015: “MADE IN CHINA” we still have to do the traditional “MADE IN CHINA”, but the core of “Made in China 2025” should be “Chinese equipment.” Li Keqiang, Premier, Nat’l People’s Cong., Speech at the Ministry of Industry and Information Technology Symposium (June 15, 2015), http://www.gov.cn/zhuanti/2016-05/16/content_5073774.html [https://perma.cc/C6VC-AHCM].

\textsuperscript{72} Hudson Lockett, \textit{How Xi Jinping Is Reshaping China’s Capital Markets}, FIN. TIMES (June 12, 2022), https://www.ft.com/content/d5b81ea0-5955-414c-b2eb-886dfe4d4ffe [https://perma.cc/3EK3-2L59].


\textsuperscript{74} Yiping Huang, ‘Strong Regulations’ of China’s Platform Economy: A Preliminary Assessment, 15 CHINA ECON. J. 125, 126–27 (2022).

The high-profile example of Didi Chuxing can be viewed generally as marking a turning point, as its anticipated delisting from the NYSE following Chinese governmental pressure was an imposition of party values against a data-rich online platform firm with a foreign IPO.77

Didi Chuxing, a major ride-hailing and -sharing service, was founded in 2012 and has its headquarters in Beijing.78 After acquiring the Chinese business of Uber in 2016, Didi dominated China’s on-demand transport sector.79 Didi handles sensitive information such as mapping data, which has been regarded as state secrets, and this has contributed to the firm’s problems,80 as it gave rise to espionage concerns by the CAC.81 Specifically, the CAC accused Didi of having violated national security, cybersecurity, and personal data laws.82 Despite the CAC’s concerns, Didi pushed forward with one of the NYSE’s largest IPOs.


82 Ryan McMorrow, Didi Fined Over $1bn by Beijing for ‘Vile’ Breaches of Data Laws, FIN. TIMES (July 21, 2022), https://www.ft.com/content/a7f0ac8a-ba8a-495b-9981-b784e7b9cd8f [https://perma.cc/RRA5-NKRK].
raising $4.4 billion on July 1, 2021.83 The CAC saw this IPO as a challenge to the central government’s authority and, in response, it initiated China’s first cybersecurity review of a private platform firm, resulting in Didi’s ride-hailing platform being banned from app stores on July 4, 2021.84 It was not until June 2022 that the debacle was brought to an end with a fine for Didi85 and a vote by its shareholders to delist.86 The penalty has greatly curtailed Didi’s prospects as it had been unable to sign up any new users, which not only adversely threatened its market share but also heavily affected the firm’s expansion plans.87 The steps taken against Didi can be seen to have marked an unprecedented period of scrutiny of data usage and security,88 demonstrating a tightening of restrictions on cross-border data flows and security and overseas listings.89 It also sends a stark message to Chinese online platform firms about the government’s authority over them, even if they operate globally and trade their stock overseas.90 Underscoring the uncertainty, the CAC’s enforcement against Didi is likely to discourage listings of Chinese firms in the United States, including the multibillions of


84 See Zhong, supra note 79.

85 Cheng Leng & Ryan Morrow, China Allows Tech Trio to Resume Business After Cyber Probe, FIN. TIMES (June 6, 2022), https://www.ft.com/content/25d515df-da4a-4613-ba54-8784804641c5 [https://perma.cc/CJB5-G3VA].

86 McMorrow, supra note 15.

87 Although its contentious IPO was in June 2021, it was not until May 2022 that Didi shareholders voted to delist. See id.


90 See id.
dollars of technology listings that are planned for New York in the years to come.91

In addition to the Didi example, there have been actions taken against notable Chinese online platforms like Ant Financial,92 Tencent,93 and Weibo94 and although there have been several reasons for these actions, they underline that CCP’s objectives such as common prosperity can be pursued at the expense of economic progress.95 Unsurprisingly, these policies impacted share prices negatively and even ruined some business models and planned IPOs.96

C. The Role of VIEs

The VIE structure, an entity in which an investor holds a controlling interest that is not based on a majority of voting rights,97 has enabled Chinese nonstate firms to access foreign capital that would be otherwise unavailable to them due to Chinese laws on foreign ownership in sensitive areas.98 Consequently,

95 For a nuanced explanation of the concept of common prosperity, see Sun, supra note 76.
96 See, e.g., Culpan, supra note 48.
98 See Jamie Powell, VIEs: China’s Nuclear Option, FIN. TIMES (Oct. 9, 2019), https://www.ft.com/content/36d69b62-1a2e-456d-8a6e-30f1f7142b15 [https://perma.cc/3TB7-L9XY].
over eighty percent of all U.S.-listed Chinese companies (ULCCs) use VIEs that are material to their operations\textsuperscript{99} and the potential to mislead investors is addressed under the HFCAA, as discussed below. A simplified structure of a VIE is illustrated in Figure 1:

\textbf{FIGURE 1}

As Figure 1 demonstrates, and for brief introductory purposes,\textsuperscript{100} the VIE is a multi-firm structure and, in the example, the company listed on the New York Stock Exchange is a shell


company in the Cayman Islands. The Cayman Islands company has the purpose of raising capital, whereas the operating side is with the Chinese Tech Co. The Chinese firm will not normally directly list, due to the restrictions on foreign investment in some sectors and others being closed to foreign capital. A Hong Kong firm is used in the illustrated structure as a conduit for tax reasons, as is a wholly foreign-owned enterprise (WFOE). Capital from the Cayman Islands company is provided to the Chinese Tech Co. in return for operational services and economic benefits that are provided to NYSE shareholders through a set of contractual relationships that mirror the rights that a shareholder would have in a traditional equity stake. In theory, VIEs allow U.S. shareholders to have the economic benefits flowing from a Chinese company while limiting their operating control of the business. This model of precarious legal structure underpins many of the biggest U.S. listings. Nearly all the big data platforms have dual-class shareholdings and VIE structures. Didi and other Chinese blue-chip firms, like Baidu, Alibaba, and Tencent (BAT), have long used the VIE structure to list on U.S. markets. They operate in a regulatory grey zone, where an investor does not have a controlling stake

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102 See supra Figure 1.


104 See Tabby Kinder et al., Beijing’s Threat to VIEs Triggers Wall Street Angst over China Stocks, FIN. TIMES (July 27, 2021), https://www.ft.com/content/38ba7bb9-9a7e-4817-80cf-324bc9a4527b [https://perma.cc/5HSQ-9ZWZ].


The VIE structure was initially tolerated by Chinese regulators, such as the China Securities Regulatory Commission (CSRC), despite its evasion of restrictions on foreign investment.\footnote{See Brandon Whitehill, Buyer Beware: Chinese Companies and the VIE Structure, COUNCIL OF INST. INVESTORS, at 6 (2017).} The foreign IPOs of most Chinese platform firms fall outside China’s jurisdiction, since they are listed in the United States in the form of VIEs but are generally domiciled in tax havens.\footnote{See, e.g., Antonio Coppola et al., Redrawing the Map of Global Capital Flows: The Role of Cross-Border Financing and Tax Havens, 136 Q. J. ECON 1499, 1527–29, 1532–33, 1532 n.29 (2021) (writing that Chinese VIEs in the Cayman Islands had a market capitalization of $1.1 trillion in 2017).} China therefore had little legal recourse and lacked an effective regulatory framework to regulate foreign listings of VIE-structured companies, and complicated structures rendered it hard for Chinese regulators to control.\footnote{See Robyn Mak, China’s VIE Problem Is Resolving Itself, REUTERS (Dec. 2, 2021, 12:02 AM), https://www.reuters.com/markets/asia/chinas-vie-problem-is-resolving-itself-2021-12-02/ [https://perma.cc/LS23-MM3U].} For instance, the Didi IPO went ahead despite requests for a delay from the State Administration for Market Regulation (SAMR).\footnote{See Lingling Wei & Keith Zhai, Chinese Regulators Suggested Didi Delay Its U.S. IPO, WALL ST. J. (July 5, 2021, 2:43 PM), https://www.wsj.com/articles/chinese-regulators-suggested-didi-delay-its-u-s-ipo-11625510600 [https://perma.cc/76L8-QKJ9].}

The VIE structure bypasses other aspects of the Chinese laws besides the restrictions on foreign investment.\footnote{See Chen, supra note 100, at 15, 18.} Regulatory requirements for IPOs in China are more stringent than those
imposed by U.S. regulators. China has much tougher listing requirements, like requisite profits, and a long and uncertain waiting period for regulatory approval. Chinese regulators require companies to have solid cash flow and earnings for listing on the domestic market, known as the A shares market. The structure has therefore played a big role in the rise of the Chinese platform companies in enabling easier access to capital.

As noted, Chinese regulators initially adopted a laissez-faire attitude to VIEs yet had also not outright endorsed the VIE framework, upon which hundreds of billions of dollars of foreign investments rely. Furthermore, the Antitrust Guidelines for the Platform Economy came into effect after the abrupt suspension of Ant Group’s IPO on February 7, 2021. The SAMR was empowered to oversee mergers and acquisitions conducted by VIEs. Positively speaking, the additional oversight from regulatory agencies could bestow a level of legitimacy on the VIE structure, which can mitigate foreign investors’ concerns about the VIE’s shaky legal ground. Nonetheless, the additional requirements will be a burden to firms seeking to list in the United States and, as discussed in Part III, they must also provide clarity regarding their VIE structures under the HFCAA.

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115 See id. at 15–17.


118 See id.


121 See id.

II. CHINESE CONCERNS AROUND CROSS-BORDER DATA

This Part is concerned with cross-border transfers of data as an intermediate problem between China and the United States that is likely to impact the fortunes of many Chinese firms listed in the United States. Chinese nonstate firms overwhelmingly dominate the supply of data that comprise China’s expansive surveillance apparatus, which presents challenges to social stability and national security.123 Some critical information infrastructure (CII) operators are at the center of the scrutiny and subject to stricter oversight than before.124 As noted, China has been tightening the rules for companies seeking to be listed overseas and heightening data security through targeting offshore IPOs,125 so the HFCAA is not the only factor liable to lead to fewer ULCCs.126 Underlying concerns are initially be identified before three key statutes are discussed.

A. Mutual Fears of Espionage

Data security issues have been at the center of China’s crackdown based on a concern that audit inspection processes required under the HFCAA could lead to a ULCC disclosing information.127 These actions reflect the mutual suspicions that have grown between China and the United States in recent years.128

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123 See Pearson et al., Party-State Capitalism, supra note 34, at 17.
126 See infra Section II.A.
There have been executive orders by both Presidents Trump and Biden barring U.S. investments in Chinese firms with believed links to the Chinese military, including Huawei. China also has sensitivities after its data vulnerabilities were exposed in the 2014 Edward Snowden revelations regarding United States National Security Agency surveillance of the Chinese technology-specialist, Tsinghua University, and the infiltration of Huawei’s servers. Ideologically, a deep-seated, related perception is that the Public Company Accounting Oversight Board (PCAOB)’s auditing inspections, enforced under the HFCAA, would facilitate the United States’ espionage against China’s economic and national security, leading to the leakage of sensitive data. In the example of Didi there were concerns that the firm’s onshore mapping data would be at risk of falling into foreign hands. China assumes that hostile foreign states may use such data to subvert the Chinese government, launch cyber-attacks, disrupt supply chains and endanger national security.

As such, the Chinese government has been willing to incur significant decoupling costs in order to exert political control, another illustration that party-state capitalism inherently involves -audits-delistings-quicktake?leadSource=uverify%20wall [https://perma.cc/V9EY-HS6W].

131 Pearson et al., Party-State Capitalism, supra note 34, at 209.
133 Yuan Yang & Sun Yu, Chinese Companies Face Uncertainty as Data Security Hawks Gain Power, FIN. TIMES (July 16, 2021), https://www.ft.com/content/9a35c71d-76b7-437c-b99f-82d0bd4d45dc [https://perma.cc/F624-S8CU].
a difficult balancing act as sustainable economic efficiency and political omnipotence do not go hand in hand.137 A contradiction inevitably persists between economic dynamism and increased authoritarian control138 and this is the case for data sovereignty too.139 Under the Beijing Model, a firm’s data sovereignty is crucial for attracting investor capital140 and China relies on its private internet giants, like BAT, to aid in intelligence and geopolitical competition.141 The Chinese government is concerned that the pace of growth of online platform enterprises has led to them being too big to regulate, resulting in the crackdowns discussed in Part I.142 The state has also sought to use data governance laws to reassert control through an ecosystem that keeps Chinese data in China, and further to maintain digital sovereignty and control through protectionist data localization mandates.143 Behind China’s regulatory action is essentially a battle for control over data between the government and those nonstate online platform behemoths.144 This Part briefly considers three statutes enacted as part of this

139 Id. at 135.
142 U.S.-CHINA & SEC. REV. COMM’N, supra note 138, at 134.
regulatory wave, the Cybersecurity Law, the Data Security Law, and the Personal Data Protection Law.


Prior to the internal crackdowns considered in Part I, there had already been legislative attention to data security, focused externally.145 The China Cybersecurity Law (CSL 2017) requires foreign firms, like Apple and Amazon, to store Chinese data within the country, and mandates them to secure a local partner to manage that hoard of information via local datacenters.146 This is the only path to a world where companies have to localize their data and are audited by local regulators.147 Cybersecurity review with a heavy emphasis on data security will become the new norm, especially toward those deemed as CII operators.148 On August 17, 2021, China’s State Council released the Critical Information Infrastructure Security Protection Regulations (CII Regulation) to fully implement the CSL 2017.149 The Regulations provide that CIIIs be given priority protection against cybersecurity risks and threats at home and abroad.150 The law prevents data from flowing freely and disproportionately prohibits cross-border transfers of information that are routine in the ordinary course of business.151

2. Data Security Law (DSL 2021)

China has also passed a data security law that forbids companies from handing over any data to foreign officials without

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146 Id.
147 See Hudson Lockett, Tabby Kinder, et al., Didi Caught as China and US Battle over Data, FIN. TIMES (July 6, 2021), https://www.ft.com/content/00403ae5-7565-413e-907d-ad46549375ba [https://perma.cc/56ZT-L6ZE].
148 Id.
150 Id. art. 5.
151 Yayboke & Ramos, supra note 143.
government approval. Its objectives are similar to those of the United States. Clarifying Lawful Overseas Use of Data Act (CLOUD Act),\textsuperscript{152} which gives U.S. authorities the power to require companies falling under U.S. jurisdiction to produce data upon request, regardless of where the data is stored.\textsuperscript{153} The Chinese law is designed to end the free harvesting of data and curtail invasive data collection by exerting systematic control over cross-border transfers of data.\textsuperscript{154} The law is particularly concerned with cross-border data security and it restricts the collection of data that may harm national security.\textsuperscript{155} The DSL 2021 prohibits enterprises from transferring “core state data” overseas without the approval of Chinese regulators.\textsuperscript{156} This means that Chinese firms need government authorization before providing any China-based data to foreign judicial or law enforcement agencies and this has been one of the obstacles to PCAOB inspections, discussed below.\textsuperscript{157} The DSL 2021 promises additional oversight of data sharing and hefty punishments for those who have breached cross-border data transfer rules: violators will be subject to a fine of up to 10 million yuan ($1.6 million) and have their operating licenses revoked.\textsuperscript{158}

3. The Personal Data Protection Law (PDPL 2021)

Chinese consumers have grown increasingly privacy-conscious in recent years, and the authorities have taken particular interest in safeguarding data collected on platforms such as Didi.\textsuperscript{159}

To this end, China has in the PDPL 2021 articulated a modern

\textsuperscript{153} Id. at 1214.
\textsuperscript{155} See id. art. 8.
\textsuperscript{156} Id. art. 36.
\textsuperscript{157} Id. art. 36; see infra note 211 and accompanying text.
\textsuperscript{159} Kubota, supra note 134.
national data policy with implications for the development of technologies. This law builds on the model of the EU’s General Data Protection Regulation\(^{160}\) and lays the groundwork for implementing concepts like user consent as well as other requirements for collecting, processing, and sharing of personal data.\(^{161}\) China’s first data protection regime strictly governs consumer data,\(^{162}\) responding to concerns about the potential national security risks associated with personal data leaving its territory.\(^{163}\) Under the PDPL 2021, data collectors must establish a specialized agency in China or appoint a representative to be responsible for data flows across borders.\(^{164}\) Storing data overseas does not exempt a firm from compliance with the PDPL 2021 given the statutory duties of privacy mitigation and security assessment on data transfer.\(^{165}\) The law requires companies to notify consumers when they are collecting and storing their data and gives consumers greater control over that data, including the right to have it deleted.\(^{166}\)

It is becoming increasingly challenging for data-rich platform firms to navigate the emerging data governance landscape.\(^{167}\) Online platform giants will have to adapt their operational models and the degree of their autonomy to comply with the Chinese laws.\(^{168}\) For example, stringent restrictions on data collection and processing will inevitably compromise the development of


\(^{162}\) Id. art. 13.

\(^{163}\) Patrick Temple-West & Demetri Sevastopulo, US Regulator Under Fire for Delays to Delisting Chinese Stocks, FIN. TIMES (July 15, 2021), https://www.ft.com/content/4212970d-b679-4f3a-a825-0ef53bf56358 [https://perma.cc/RMM3-X76G].


\(^{165}\) Id. art. 40.

\(^{166}\) Id. arts. 14–15.

\(^{167}\) Yang & Yu, supra note 133.

\(^{168}\) White & Yu, supra note 144.
AI. Thus, it is essential to the prosperity of Chinese firms operating across borders for China to strike a balance between materially limiting Chinese tech giants’ ability to process data and proportionately controlling data flows across borders.170

B. Controls on Foreign Listings by Chinese Companies: Ex Ante Approval vis-à-vis Ex Post Oversight

Alongside the data security laws discussed above, the CAC expanded its national security review, proposing broad new rules to limit overseas listings.171 The CAC’s Cybersecurity Review Measures require that firms seeking to list abroad must undergo relevant security screening procedures to ensure they comply with Chinese laws.172 Firms are mandated to register with the CSRC within three working days after the first filing for foreign IPO.173 The registration is followed by a cybersecurity review which focuses on the possible impacts on CII continuity, compliance with Chinese law and an assessment of risks that core data or personal data could be leaked, exported, or used by foreign governments.174 The process in straightforward cases is expected


170 See id.; White & Yu, *supra* note 144.


174 [Cybersecurity Review Measures] (Promulgated by Cyberspace Admin. of China, Feb. 15, 2022, effective Feb. 15, 2022), art. 10, 2022 P.R.C. LAWS
to be completed within thirty working days, but complex cases can take ninety days and others can be extended beyond this.

The Review Measures aim to provide a predictable framework for overseas listing. It clarifies proceedings in a market rocked by the state’s crackdown on overseas listings. Chinese government agencies will check sources of funding for securities investment and control leverage ratios, as a means of reasserting state control over the VIE-driven firms which have taken advantage of regulatory arbitrage. VIE structures were discussed in Section I.C above and will be returned to in Part III but are briefly noted here as they were at one time considered to be under threat of being banned in China and the Review Measures have provided an alternative to such drastic action. Together these developments constitute an overhaul of how Chinese firms list on stock markets in the United States. Whilst the effects on some of the world’s most innovative companies may be crippling, especially in conjunction with increased scrutiny of ULCCs, they should, however, reduce the risk for investments in those Chinese firms which do pass the screening process.

1. Ex Ante Jurisdictional Control

The CAC is also taking a lead role to tighten regulations over ULCCs, with particular regard to tightened enforcement over cross-border transfers of sensitive information that will


175 Id. at art. 11.
176 Id. at art. 14.
177 See, e.g., Bramble, supra note 136.
178 See, e.g., id.
179 Chen, supra note 100, at 6.
182 See Bramble, supra note 136.
impact online platform firms.\textsuperscript{183} It has mandated a data security review through which firms with more than one million users seeking overseas listing must gain clearance, including a review of potential ramifications involved in data transfers.\textsuperscript{184} The new measures are set to significantly delay the listing process and add uncertainties.\textsuperscript{185} They may impose long waiting periods on any companies hoping to list abroad, which will hit investor sentiment, depress valuations for IPOs, and make it more difficult to raise funds overseas.\textsuperscript{186} A worst scenario could be that the CSRC would prevent any platform firms with large amounts of user data from filing for overseas IPOs.\textsuperscript{187} These challenges have also rendered it difficult for Chinese firms to raise capital under stringent restrictions on overseas IPOs.\textsuperscript{188} Despite the lucrative source of funding for Chinese firms offered by foreign listing, the risk of additional scrutiny would potentially deter some from doing so.\textsuperscript{189} Amidst the ongoing turmoil, many tech firms have reportedly shelved their overseas IPO plans.\textsuperscript{190} For instance, ByteDance reportedly decided to delay its IPO efforts over concerns stemming from data security risks.\textsuperscript{191}


\textsuperscript{185} See Guo & Li, supra note 171.

\textsuperscript{186} See, e.g., ANDREW COLLIER, CHINA’S TECHNOLOGY WAR: WHY BEIJING TOOK DOWN ITS TECH GIANTS 46–68 (2022).

\textsuperscript{187} Bramble, supra note 136.

\textsuperscript{188} See id.


\textsuperscript{191} See id.
2. Ex Post Mandatory Requirements

China is stepping up its regulatory oversight of ULCCs as well.\textsuperscript{192} VIEs that have already gone public may need approval if they seek a secondary offering.\textsuperscript{193} A data security framework has heightened supervision of all Chinese firms listed offshore and tightened rules for cross-border data flows.\textsuperscript{194} The requirement marks a further tightening of government control, and thus ULCCs will be held accountable for keeping their data secure.\textsuperscript{195} It thus erects another unpredictable regulatory hurdle that could deter foreign investors.\textsuperscript{196} The new rules will have huge implications in China, one of the most data-restrictive countries in the world.\textsuperscript{197} The overhaul represents a major step to tighten scrutiny on overseas listings.\textsuperscript{198} The rules would create extraterritorial

\textsuperscript{192} See, e.g., Intent on Decoupling, supra note 181; [Cybersecurity Review Measures] (promulgated Feb. 15, 2022, effective Feb. 15, 2022), arts. 1–2, 2022 P.R.C. LAWS (China).

\textsuperscript{193} [Cybersecurity Review Measures] (promulgated Feb. 15, 2022, effective Feb. 15, 2022), art. 1, 2022 P.R.C. LAWS (China).


\textsuperscript{196} Minxin Pei, China Is Killing Its Tech Golden Goose, PROJECT SYNDICATE (July 12, 2021), https://www.project-syndicate.org/commentary/china-govern ment-crackdown-on-didi-and-technology-firms-by-minxin-pei-2021-07 [https://perma.cc/7NE5-GRV6].


\textsuperscript{198} See, e.g., Pei, supra note 196.
laws to govern Chinese firms with foreign listings, which would be subject to severe sanctions for non-compliance. One by-product of the increased scrutiny could be fewer Chinese IPOs on U.S. exchanges and an acceleration of those large ULCCs’ secondary or even primary listings in mainland China or Hong Kong. A positive side effect is that the stricter oversight of overseas listings may improve the regulatory framework for companies listing shares overseas. Apart from improving regulation of cross-border data flows and security, China is also seeking to crack down on illegal activity in the securities market and punish fraudulent securities issuance and market manipulation.

### III. U.S. REGULATORY TENSIONS

Whilst there have been significant developments on the Chinese side that threaten to undermine Chinese listings on U.S. exchanges, the more immediate threat had appeared to be the HFCAA which enhances investor protection by addressing three long-term problems. First, as previously mentioned, there had been long-standing problems of compliance with PCAOB audit inspection requirements, and the Holding Foreign Companies Accountable Act addresses this through the threat of delisting. Second, the HFCAA also requires information regarding ownership or control of a firm by a foreign government, addressing

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201 See, e.g., Bramble, supra note 136.


203 Commonly translated in Chinese as Wàiguó gōngsī wèn zé fǎ (外国公司问责法).

concerns of Chinese state control of nonstate firms. Thirdly, it also addresses the problems of VIEs. As noted in Part I, the VIE structure has enabled Chinese firms to list abroad without enduring the lengthy and rigorous vetting processes in China’s domestic markets and restrictions on foreign ownership. Yet the use of these VIE vehicles has been opaque for investors and the HFCAA requires greater clarity.

A. Audit Inspections

The HFCAA addresses long-standing concerns regarding Chinese firms listing on U.S. exchanges by strengthening the Sarbanes-Oxley Act of 2002 (SOX). SOX had addressed accounting scandals at major firms, including Enron, and in the interests of investor protection it introduced a system of audit inspections of public accounting firms by the PCAOB. There has been a deadlock as Chinese companies are prohibited from compliance under state secrecy provisions and so neither ULCCs nor subsidiaries of the Big Four firms in China have been allowed to share their audit papers with the PCAOB.

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205 Id. § 7214(i)(2)(B).
207 See supra notes 97–98 and accompanying text.
208 See supra note 7 and accompanying text.
212 Audit firms are also impacted. Tabby Kinder & Michael O’Dwyer, Big Four Auditors Squeezed Between US and China, FIN. TIMES (Apr. 29, 2021), https://www.ft.com/content/27a148ba-adba-425e-8d59-c22c3bb36ad8 [https://perma.cc/U6ET-559R]. As a result of the conflict between the CSRC and the SEC, auditors face the threat of enforcement actions in both China and the United States. The Chinese operations of the Big Four could be deregistered by the PCAOB, blocking them from auditing ULCCs. Id.
213 Id.
PCAOB’s failure to obtain the underlying audit inspections of Chinese firms undermines the investor protections built into the U.S. capital market regimes and, as a result, egregious accounting frauds were not detected, exposing investors to material risks and resultant losses.\textsuperscript{214} Most notably, Luckin Coffee, a New York–listed firm, had admitted to fabricating over $310 million of its sales,\textsuperscript{215} contributing to the HFCAA backlash.\textsuperscript{216} The frauds also damaged the ULCCs’ international image and adversely affected their overseas financing.\textsuperscript{217} The effect of PCAOB non-compliance has been estimated as a 5–7% valuation haircut for Chinese firms associated with negative publicity.\textsuperscript{218}

The HFCAA process is for the SEC to identify any issuers who are in default, based on determinations by the PCAOB.\textsuperscript{219} The PCAOB will determine whether any U.S.-listed companies have retained auditors with a branch or office in a foreign jurisdiction and which the PCAOB has been unable to inspect or investigate properly because of policies in that jurisdiction.\textsuperscript{220} As annual reports were filed in March 2022, the PCAOB was able to identify an increasing number of Chinese companies as non-compliant—174 in December 2022\textsuperscript{221}—and their audit firms were required to enable audit inspections or else the companies would face the prospect of being delisted within three years.\textsuperscript{222}

\textsuperscript{214} See id.
\textsuperscript{215} Richard Henderson & Hudson Lockett, Nasdaq to tighten requirements for companies seeking to list, FIN. TIMES (May 16, 2020), https://www.ft.com/content/37849c96-a932-43cc-8d0a-77a21675fe6 [https://perma.cc/KAV9-Y39U].
\textsuperscript{216} Christian Shepherd and Yuan Yang, China Targets More Tech Groups After Didi Crackdown, FIN. TIMES (July 5, 2021), https://www.ft.com/content/771f6d40-ec2d-4855-8193-d0550f1d2e3d [https://perma.cc/G9SJ-V9D8].
\textsuperscript{218} Id.
\textsuperscript{219} Id.
\textsuperscript{220} Holding Foreign Companies Accountable Act, SEC (Jan. 9, 2023), https://www.sec.gov/hfcaa [https://perma.cc/98YA-3FQA].
\textsuperscript{221} Id.
Following the listing of 174 firms as candidates for delisting under the HFCAA the CSRC published a response to a reporter’s request for comment. In its response the CSRC showed respect for efforts to “enhance oversight of relevant accounting firms to improve the quality of financial disclosure by listed companies.”223 The statement also indicated that there was ongoing engagement with the PCAOB, focused on resolving the deadlock created by conflicting U.S. and Chinese regulatory requirements.224 There was reportedly also a summit with leading U.S.-listed firms, including Alibaba Group, Weibo Corp, Baidu, JD.com, Pinduoduo Inc. and NetEase Inc.225 These moves indicated a softening of China’s approach, and the CSRC and the Ministry of Finance of the People’s Republic of China subsequently signed a Statement of Protocol with the PCAOB to enable inspections.226

The agreed-upon terms under the Statement of Protocol are stringent, reflecting the HFCAA’s emphasis on inspecting and investigating “completely,” and grant the PCAOB access to Chinese- and Hong Kong-headquartered audit firms for the first time.227 The PCAOB is given sole discretion to select the firms, audit engagements, and potential violations by firms under inspection and investigation, and to do so without consultation or input from Chinese regulators.228 Under the agreed-upon procedures, the PCAOB can view complete audit work papers, with all information included, and retain information as required.229 The PCAOB can also interview and take testimony from all personnel associated with the relevant audits.230 Happily, two initial

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224 Id.
226 PUB. CO. ACCT. OVERSIGHT BD., supra note 10.
228 Id.
229 Id.
230 Id.
inspections of audit firms, a Chinese mainland affiliate of KPMG and a Hong Kong affiliate of PWC, that took place over a nine-week period in 2022\textsuperscript{231} appear to have satisfied U.S. regulators’ meticulous approach to compliance, with access to all documentation having been allowed without withholding or redacting any information, which has apparently removed the threat of delisting for approximately 200 companies.\textsuperscript{232} This achievement might seem to reflect a significant softening of China’s approach, but threats of delisting will abate only if inspectors gain full and timely access to information on an ongoing basis.\textsuperscript{233}

The softening of China’s approach is important as it is the only likely way for the audit inspection standoff to be resolved. There would be little to be gained for the SEC in relaxing its approach to enforcement of the HFCAA, had there been incomplete compliance with the Statement, given the long standing previous lack of cooperation and a need for enhanced investor protection.\textsuperscript{234} Whilst a refusal to allow exceptions could have threatened some of the nearly $2 trillion worth of shares on Wall Street, this would not significantly impact the U.S. economy or the U.S. financial system and might be considered a price worth paying to strengthen investor protections.\textsuperscript{235} Delistings may threaten a lucrative source of capital for the U.S. investment banks,\textsuperscript{236} but this is unlikely to be persuasive in bringing about a less strict approach to enforcement of the HFCAA.\textsuperscript{237} It is therefore important that China has relaxed its approach, and consequently averted the threat of large-scale delistings.\textsuperscript{238} Moreover, any firms that remain under

\begin{footnotesize}
\begin{enumerate}
\item[Foley, supra note 65.]
\item[See Foley, supra note 65.]
\item[Beyoud et al., supra note 232.]
\item[Jamie Powell, Tell Me Lies, Tell Me Sweet Little VIEs, FIN. TIMES (July 8, 2021), https://www.ft.com/content/ceb9d46b-5795-4da1-8ac1-50ba9221ff1e [https://perma.cc/QBD2-UWYR]; Henderson & Lockett, supra note 215.]
\item[Hudson Lockett et al., China Offshore Listings Clampdown Threatens Wall Street, FIN. TIMES (Dec. 15, 2021), https://www.ft.com/content/30d0d084-eb0d-4b68-a982-dfe24554a1ad [https://perma.cc/79TV-ACFD].]
\item[Henderson & Lockett, supra note 215.]
\item[Yang et al., supra note 225.]
\end{enumerate}
\end{footnotesize}
threat may prefer to voluntarily delist and join the Hong Kong Stock Exchange or be taken private, possibilities that are considered below.

1. Clarity Regarding Group Structures and VIEs

Audit inspections are not the only concerns under the HFCAA regarding investor protection. The HFCAA Disclosure rules address the potential for investors to be misled by VIE structures into thinking that they are investing in Chinese firms directly. The disclosure rules require issuers to distinguish between shell companies and the operating companies in China, including the enforceability of certain contractual arrangements. Thus, investors would have information regarding the VIE contractual arrangements, which, as noted, can be misleading for investors. The firms should also disclose whether Chinese law allows them to list in the United States via an offshore shell company. For instance, Didi did mention some of the regulatory risks to its operations but gave no indication that the CAC would start investigating the firm and ban its apps, preventing investors from being fully aware of possible risks. Such disclosures are not only crucial to inform investment decision-making but are also at the heart of the SEC’s mandate to protect investors in the U.S. capital markets.

2. SEC’s Remedial Actions: More Stringent Disclosure Obligations

U.S. regulators have also addressed the problem that Chinese markets are much more opaque and subject to political control than those in the West, which has made demands for

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240 Id.
241 Id.
242 Id.
243 Hopkins et al., supra note 109.
Western-style transparency far more complicated.\textsuperscript{246} As part of the action taken to improve the information available to U.S. investors, the SEC temporarily suspended new listings of Chinese companies.\textsuperscript{247} The SEC will also only permit a Chinese firm to list in the United States if it fully discloses its structures and state ties—such as the percentage of shares of the issuer owned by governmental entities\textsuperscript{248}—and identifies risks, including the prospect of Chinese governmental intervention.\textsuperscript{249}

3. Foreign Government Ownership or Control

The HFCAA also requires the disclosure of information regarding ownership or control by foreign governments.\textsuperscript{250} Chinese state agencies are involved in many private companies through golden shares, CCP membership is common among firm management, and many firms have party cells.\textsuperscript{251} There may be doubts, however, as to whether these elements alone or cumulatively can combine to establish government control.\textsuperscript{252}

“Golden shares”\textsuperscript{253} are a key governance structure in respect to nonstate firms, including many high-profile companies, many of which have listed in the United States.\textsuperscript{254} A state agency will typically hold a one percent or other small-sized investment, which can bring the power to appoint a director.\textsuperscript{255} For example, in the online platform sector, golden shares are held by China’s Internet Investment Fund, which is mostly owned by the CAC

\textsuperscript{246} Sommer, supra note 117.
\textsuperscript{247} Gensler, supra note 245.
\textsuperscript{252} See id.
\textsuperscript{253} Bernardo Bortolotti & Mara Faccio, \textit{Government Control of Privatized Firms}, 22 REV. FIN. STUDS. 2907, 2939 (2009).
\textsuperscript{254} Yang et al., supra note 251.
\textsuperscript{255} Pearson et al., \textit{International Backlash}, supra note 41.
and has small shareholdings in data-rich platforms, such as trucking platform Full Truck Alliance, TikTok owner Byte Dance, and audio platform Ximalaya. These shares enable state agencies to monitor the collection, storage, and usage of customer data by these firms and they can be mutually beneficial in potentially enabling regulatory concerns to be addressed in-house, avoiding episodes like the Didi debacle, discussed above in Section I.B. Notably, however, the shares will tend to only offer potential to address decisions at board level, rather than enabling influence to be exerted in day-to-day operations. By themselves, golden shares would therefore not seem to create government control for the purposes of the HFCAA.

Another relevant factor in assessing foreign government ownership or control may be the CCP’s party cells. These cells have long been established in nonstate firms by the CCP for political reasons but have grown in usage in recent years, with a presence in an estimated seventy-three percent of firms, stoking external suspicions. Huawei is given as an early example of strong party involvement in a firm through the establishment of CCP cells.

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256 Yang et al., supra note 251.

257 Golden shares have also been used to keep a rein on firms handling large amounts of personal data. Id.


259 See id. Regulatory issues may also arise in other departments than the one which holds the golden share, nor have golden shares always prevented regulatory action being taken. Id.

260 Id.


of a party committee, but it also highlights that the relationship may not always be as onlookers expect.\textsuperscript{264} Party members reportedly had difficulties in adjusting to “shrewd, successful and self-confident global entrepreneurs” who would not blindly follow directions.\textsuperscript{265} CCP party cells do, however, provide benefits to nonstate enterprises insofar as small enterprises may find party links helpful in obtaining payments, as Huawei did in its early years.\textsuperscript{266} Huawei’s party cell has also been identified as having involvement in mentoring and other personal development activities.\textsuperscript{267} Other nonstate companies have found that party cells bring tax benefits, improve access to credit, and provide ways around regulatory limits.\textsuperscript{268} It is also notable that personal links with the party have been mutually beneficial in terms of strong ties based on \textit{guanxi}, which are important in Chinese business culture.\textsuperscript{269} These factors have also been evident in Chinese multinationals, although they also operate alongside other complex business relationships and can be changed in the process.\textsuperscript{270} An illustration is ByteDance’s refusal to allow a TikTok account to be created for propaganda towards Western audiences.\textsuperscript{271} Again, the presence of a party cell is arguably not sufficient in itself to establish Chinese government control.\textsuperscript{272}

\textsuperscript{264} See Koss, \textit{supra} note 262, at 227.
\textsuperscript{265} \textit{Id.}
\textsuperscript{266} Colin Hawes, \textit{Why is Huawei’s Ownership so Strange? A Case Study of the Chinese Corporate and Socio-Political Ecosystem}, 21 \textit{J. CORP. L. STUDS.} 1, 5 (2021).
\textsuperscript{267} \textit{Id.} at 19.
\textsuperscript{268} \textit{Id.} at 6.
\textsuperscript{269} Christopher A. McNally & Teresa Wright, \textit{Sources of Social Support for China’s Current Political Order: The “Thick Embeddedness” of Private Capital Holders}, 43 \textit{COMMUNIST POST-COMMUNIST STUDS.} 189, 190 (2010).
\textsuperscript{272} See Koss, \textit{supra} note 262, at 227.
B. Dual-Listings in the HKEX: A Lifeboat for Those Delisted?

Given the recent difficulties of U.S. cross-listings, including Didi's ordered delisting, to be followed by possible delistings under the HFCAA, the incentives for some Chinese firms to pursue U.S. listings may have declined, potentially to the benefit of other exchanges.\(^{273}\) At the same time, China has conducted strategic development of its own capital markets as it seeks to be less reliant on those in the United States.\(^{274}\) China has been heavily bolstering its exchanges in Beijing, Shenzhen, and Shanghai as viable options for raising capital.\(^{275}\) The primary immediate beneficiary of a U.S. delisting trend would, however, appear to be the Stock Exchange of Hong Kong Limited (HKEX).\(^{276}\) Hong Kong has benefited from both the U.S.’ tougher inspection of ULCC’s audits and China’s regulatory clampdown as a favored IPO center for Chinese firms to raise foreign capital.\(^{277}\) As the decoupling of the equity markets accelerates, Didi’s expected withdrawal from the NYSE and relisting on the HKEX could serve as a catalyst for the revival of its business prospects.\(^{278}\) The strategy would potentially draw other ULCCs to a secondary listing as a hedge against the U.S. delisting risk to facilitate a smooth withdrawal from the U.S. capital markets.\(^{279}\) Chinese tech behemoths, like


\(^{275}\) Id.


\(^{277}\) See id.

\(^{278}\) See Tom Mitchell, Why Xi Jinping Changed Tack in His Crackdown on Didi, FIN. TIMES (July 21, 2022), https://www.ft.com/content/6a6b150a-f32e-42d8-8b68-26f3548ad20b [https://perma.cc/W6SE-P24V].

Alibaba, JD.com and NetEase, have already begun protecting their interests with secondary listings on the HKEX.\textsuperscript{280} There have been aspects of a regulatory race in the ascent of the HKEX and its approach to dual class shares.\textsuperscript{281} Carruthers and Lamoreaux noted that a regulatory race requires:

i. an initial difference in regulatory rules across jurisdictions;

ii. the credible threat that firms’ locational decisions will be affected by that difference; and

iii. a move by jurisdictions with more burdensome rules to change their regulations in response to the threat.\textsuperscript{282}

The HKEX’s approach to dual-class shares previously could have deterred migrations from the United States following the HFCAA.\textsuperscript{283} In 2018, the HKEX changed its rules to allow firms with dual-class shares to list, which also instituted landmark revisions to the Hang Seng Index.\textsuperscript{284}

The HKEX Listing Rules offer a new concessionary route which allows firms that are already primarily listed on a Qualifying Exchange, including the NYSE, NASDAQ, and the Main Market of the London Stock Exchange (LSE), to apply for a secondary listing in Hong Kong.\textsuperscript{285} This change in attitude towards permission of the dual-class IPOs well epitomizes the regulatory

\textsuperscript{280} Hudson Lockett & Richard Henderson, China Stock Listings on Wall Street Accelerate Under Trump, Fin. Times (Oct. 11, 2020), https://www.ft.com/content/1acd60ed-f549-430e-822c-8155baf125a8 [https://perma.cc/LW4A-P7LL].

\textsuperscript{281} Bruce G. Carruthers & Naomi R. Lamoreaux, Regulatory Races: The Effects of Jurisdictional Competition on Regulatory Standards, 54 J. Econ. Lit. 52, 53–54 (2016).

\textsuperscript{282} Id.


race theory, and the reform has paved the way for ULCCs to list in the HKEX. In November 2019, Alibaba’s secondary listing in the HKEX helped it secure nearly $13 billion in capital. Alibaba’s success has mainstreamed a growing trend of secondary listings by Chinese tech giants. For example, JD.com Inc. and NetEase Inc. were secondarily listed in HKEX in April and June 2020, which raised $4.4 billion and $3.1 billion, respectively.

With more and more ULCCs setting up secondary listings to mitigate the fallout, Hong Kong has seemingly emerged as a leading capital-raising hub for Chinese tech firms. Nevertheless, Hong Kong’s dwindling political freedoms may impact its appeal as a globalized financial center. Erosion of the rule of law could lessen future foreign capital inflows, ultimately impacting Hong Kong’s status as an international financial center. This is especially true in terms of the delisting and relisting strategy exploited by many Cayman-incorporated companies. After all, whether a regulatory race ensues depends on how China...

287 See HKEX, supra note 285.
291 Calhoun, supra note 54.
292 Id.
responds and whether it alters its own policies with the aim of preventing movements of capital.\textsuperscript{295}

\textbf{C. Returning to Private Ownership or Otherwise Voluntarily Delisting}

A return to private ownership is a possibility for some U.S.-listed Chinese firms, which are commonly controlled by founding entrepreneurs who may prefer to take the firm private, rather than list on another exchange.\textsuperscript{296} The entrepreneur would typically cash out by making an offer to the board of the listed company, “Listco,” to acquire the remaining shares, deregister, delist, and go private.\textsuperscript{297} In the VIE structure previously discussed and illustrated in Figure 1, the Cayman Islands company is Listco. The relevant processes, directors’ duties, and voting requirements would therefore be those of the jurisdiction where the listed company is incorporated, in this example, the Cayman Islands.\textsuperscript{298} There would however also be regulatory requirements associated with delisting from the U.S. exchange, as well as approval requirements in China for investment in a foreign company.\textsuperscript{299}

In cases where the entrepreneur lacks financing to make a cash-out offer, another possibility may be to “go dark” through delisting and deregistration.\textsuperscript{300}

\textbf{IV. SIGNS OF DECOUPLING?}

The wider U.S.-China trade relationship is valuable to both sides, yet it may prove difficult to chart a middle path between

\textsuperscript{295} Carruthers & Lamoreaux, \textit{supra} note 281.


\textsuperscript{297} Id.

\textsuperscript{298} Id.

\textsuperscript{299} Id.

outright decoupling and unconditional engagement. The HFCAA is only one possible source of a split of Chinese companies from the U.S. markets, leaving aside wider political differences, as China has ambitions to become less reliant on foreign capital and foreign technology. Achievement of these ambitions is unlikely to be straightforward.

A. Ending Reliance on Foreign Technology

A major Chinese strategy, set out in Made in China 2025, contained plans to be independent of foreign technology and to divert from exports of manufactured goods and towards an ambitious industrial strategy that prioritizes ten areas of emerging and established technologies, including robotics, aerospace, pharmaceuticals, and advanced medical equipment, among others. External controversy contributed to the Made in China 2025 strategy being toned down in rhetoric. However, it also led to Chinese ambitions regarding self-sufficiency in key industries, concerns which are particularly heightened in the case of semiconductors.

301 See Building Resilient Supply Chains, Revitalizing American Manufacturing, and Fostering Broad-Based Growth, WHITE HOUSE (June 2021), https://www.whitehouse.gov/wp-content/uploads/2021/06/100-day-supply-chain-review-report.pdf [https://perma.cc/5HFC-SQT3].

302 See Yeh et al., supra note 296.

303 See Building Resilient Supply Chains, Revitalizing American Manufacturing, and Fostering Broad-Based Growth, supra note 301.


Semiconductors are vital to high-tech supply chains, crucial to China’s other technological ambitions, and they could prove to be a real pinch point. This sector is particularly sensitive, with the contested Taiwan acting as the leading exporter, even more so after U.S. sanctions. There had been U.S. concerns that semiconductors supplied to the leading Chinese firm Semiconductor Manufacturing International Corporation (SMIC) and its affiliates could be diverted to military end usage, which led to SMIC and its affiliates being added to the Entity List and therefore subject to an export blacklist. More recently, the Chinese pain has been increased by the Chips and Science Act, signed into law by President Biden on August 9, 2022, which provides grants for semiconductor manufacturers in the United States and requires that recipients of this funding do not upgrade Chinese factories for ten years. Importantly, non-U.S. companies are eligible for these grants, a carrot that could tempt South Korean manufacturers. There is also an important stick of civil and criminal penalties for those who violate U.S. export controls, a threat magnified by its broad and underdefined...
Given the wide usage of semiconductors in modern electronics, the U.S. restrictions are likely to be highly damaging for Chinese firms, given the enormous task ahead of China if it is to develop self-sufficiency in semiconductors, particularly high-end types of semiconductors.\textsuperscript{316} China has plans for not just self-reliance but also dominance in key high-end areas of technology\textsuperscript{317} that may also be scuppered by its semiconductor woes. It has been noted as common for Chinese policymakers to express “that third-tier companies make products, second-tier companies design technology, and first-tier companies set standards.”\textsuperscript{318} Successive initiatives have aimed to propel China from the third tier to the first tier.\textsuperscript{319} The China Standards 2035 project signals first-tier ambitions to be a leader in setting standards for technology which would disrupt Western hegemony in this regard.\textsuperscript{320} There are also ambitions to pioneer a new general-purpose technology, based on data, communication, and artificial intelligence.\textsuperscript{321}


\textsuperscript{316} See Agrawal, supra note 314.


\textsuperscript{319} Id.


B. Ending Reliance on Foreign Capital

China also has a goal of decreasing its reliance on U.S. stock exchanges while building up homegrown finance.322 As a high-savings country and a net exporter of capital, China may consider that it does not need U.S. listings of its companies to import more capital and it can turn inwards in this way.323 Yet its own capital markets are, as noted, not yet optimal and they can yet be bolstered by stronger capital market regulation.324 There have, however, already been flagship Chinese companies that have delisted, such as semiconductor firm SMIC325 and other high-end technology firms, with Chinese oil giant China Petroleum & Chemical Corp also expected to delist from the United States alongside other state-owned enterprises.326

There has also been a sharp decline in Chinese direct investment in the United States.327 This drop reflects increased surveillance of inbound Chinese investment by the Committee on Foreign Investment in the United States (CFIUS) and, more importantly, a sharp increase in the control of outbound capital by the Chinese authorities.328 China, therefore, seems intent on reducing the reliance of its companies on the U.S. capital markets,329 despite recent trends towards compliance with HFCAA

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323 Id.
325 Yang & Liu, supra note 309.
328 Id.
329 Intent on Decoupling, supra note 181.
audit inspection requirements. Yet, a remaining problem for the CCP is that economic growth has long been key for the CCP’s legitimacy, but it has been damaged by the pursuit of other policy objectives that have led to the value of some ULCCs being pummeled. There has already been a decline in foreign investment due to concerns regarding the crackdowns on online platforms and other firms that are perceived as undermining common prosperity. With these hawkish state trends, Chinese firms risk losing access to the United States’ deep capital markets as well. It has been estimated that China could lose roughly $45 trillion in new capital flows in and out of China by 2030, and it is imperative that alternative growth drivers are in place.

CONCLUSION

Chinese firms that have listed on U.S. stock exchanges face problems from both countries. U.S. investor protections have been enhanced through the HFCAA and could yet result in the delisting of some Chinese companies, despite the recently agreed-upon Statement of Protocol and successful inspection of two audit firms. Enforcement of audit inspection requirements is still in


333 Horta e Costa, supra note 49.


its early days and there may yet be audit firms unwilling or unable to cooperate fully with PCAOB audit inspections. At the same time, the CCP has damaged shared values through the reassertion of party values in its hundredth year, reining in many non-state firms, and taking major steps to protect data, as exemplified by the hapless Didi Chuxing. The Didi case, alongside cybersecurity restrictions, illustrates that Chinese state regulators are protective of data security even if this is likely to damage a firm’s prospects. Ambitions to grow with the use of Chinese capital and Chinese technology are also reshaping the dynamic, but semiconductors may yet prove to be the stumbling block for these ambitions. In the longer term, the stream of listings of Chinese nonstate firms on United States exchanges may slow, given the possible difficulties of HFCAA compliance and the revised cybersecurity laws, but fall short of a decoupling.