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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

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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

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[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).

[2] *Chinese Companies Listed on Major U.S. Stock Exchanges*, U.S.-CHINA ECON. & SEC. REV. COMM'N (Jan. 9, 2023), https://www.uscc.gov/research/chinese-companies-listed-major-us-stock-exchanges [https://perma.cc/YM9K-ESRF].

[3] Zhang & King, *supra* note 1, at 72.

[4] Holding Foreign Companies Accountable Act, Pub. L. No. 116-222, 134 Stat. 1063 (2020) (amending Section 104 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7214); Stephen Foley, *U.S. Regulators Gain Access to Audits of Chinese Companies*, FIN. TIMES (Dec. 15, 2022), https://www.ft.com/content/2dcc601a-2299-49b0-9f83-c0d4d6be2e84 [https://perma.cc/JRC4-ZNMV].

[5] Earl Carr, *The Future Of Chinese Companies Listing In The US*, FORBES (Sept. 1, 2022, 3:57 PM), https://www.forbes.com/sites/earlcarr/2022/09/01/the-future-of-chinese-companies-listing-in-the-us/?sh=7830b4d5fd69 [https://perma.cc/PA2S-P87H].

[6] Adam Hayes, *Variable Interest Entities (VIE): Definition and How They Work*, INVESTOPEDIA (May 11, 2022), https://www.investopedia.com/terms/v/variable-interest-entity.asp [https://perma.cc/JX9S-3KAK]; [Foreign Investment Law of the People's Republic of China] (promulgated by the Second Session of the 13th National People's Congress on Mar. 15, 2019, effective Jan. 1, 2020) NAT'L DEV. & REFORM COMM'N (NDRC) NAT'L PEOPLE'S CONG. art. 28.

risks to Chinese investments presented by state interference, concerns that are also addressed under the HFCAA.[7]

The HFCAA was enacted in the face of Chinese resistance to the audit inspections required under the Sarbanes-Oxley Act.[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.[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.[10] The response by U.S. regulators to this agreement "on paper" was guarded, and a need for unfettered access has been emphasized.[11] Any failure to comply would have put listings of some major Chinese companies

[7] *See* 15 U.S.C. § 7214.

[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 PCAOB 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/pcaob-enters-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. *PCAOB 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/pcaob-renews-cooperative-agreement-with-french-audit-regulator [https://perma.cc/NF7C-J2KV].

[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., *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).

[10] *See PCAOB Signs Agreement with Chinese Authorities, Taking First Step Toward Complete Access for PCAOB to Select, Inspect and Investigate in China*, PUB. CO. ACCT. OVERSIGHT BD. (Aug. 26, 2022), https://pcaobus.org/news-events/news-releases/news-release-detail/pcaob-signs-agreement-with-chinese-authorities-taking-first-step-toward-complete-access-for-pcaob-to-select-inspect-and-investigate-in-china [https://perma.cc/8BC7-TJJC].

[11] *Id.*

at risk, including some giants in the online platform sector.[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.[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.[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),[15] and, prior to that, Luckin Coffee.[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.[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.[18]

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[12] This Article uses the term "online platform" broadly to identify firms which offer services primarily online, following the OECD definition. *See What is an "Online Platform"?*, *in* AN INTRODUCTION TO ONLINE PLATFORMS AND THEIR ROLE IN THE DIGITAL TRANSFORMATION, 19–20 (2019).

[13] Richard Smith et al., *PCAOB Secures Complete Inspection Access to Audits of Chinese Companies, Removing Delisting Risks*, ORRICK (Dec. 21, 2022), https://www.orrick.com/en/Insights/2022/12/PCAOB-Secures-Complete-Inspection-Access-to-Audits-of-Chinese-Companies-Removing-Delisting-Risks [https://perma.cc/YQ6H-94HN].

[14] Reuters, C*hina and US Sign Deal That Could Avert Mass Stock Delistings*, CNN (Aug. 26, 2022), https://www.cnn.com/2022/08/26/investing/china-us-delisting/index.html [https://perma.cc/7RAB-8GPE].

[15] Although its contentious IPO was in June 2021, it was not until May 2022 that Didi shareholders voted to delist. Ryan McMorrow, *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].

[16] *See* Peng et al., *supra* note 9, at 1–2.

[17] Emma Lee, *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].

[18] Filipe Pacheco & Jeanny Yu, *How and Why Chinese Firms Are Listing in Europe Now*, WASH. POST (Aug. 22, 2022, 5:01 AM), https://www.washington

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.[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,[20] and even predictions of financial decoupling.[21] China has also been taking dramatic steps to safeguard its data security[22] in the face of the Edward Snowden leaks regarding U.S. surveillance.[23] A Chinese desire to be less reliant on foreign capital has also been influential, and there are

post.com/business/how-and-why-chinese-firms-are-listing-in-europe-now/2022/08/19/eb928f80-1f8b-11ed-9ce6-68253bd31864_story.html [https://perma.cc/QBT8-YM8D].

[19] On the tech war and possible consequences, see Haiyong Sun, *U.S.-China Tech War Impacts and Prospects*, 5 CHINA Q. INT. STRATEG. STUD. 197, 211–12 (2019) (arguing that tensions between the United States and China are having an impact on the technology industry). This Article does not consider wider sources of difference between the United States and China arising from the relationship with Russian and Ukraine war and the Taiwan dispute.

[20] For example, the addition of Huawei and later Semiconductor Manufacturing International Corporation Incorporated (SMIC) to the U.S. Entity List on national security grounds. Addition of Entities to the Entity List, 84 Fed. Reg. 22,961, 22,961–62 (May 21, 2019) (to be codified at 15 C.F.R. pt. 744); Addition of Entities to the Entity List, Revision of Entry on the Entity List, and Removal of Entities From the Entity List, 85 Fed. Reg. 83,416, 83,418 (Dec. 20, 2020) (to be codified at 15 C.F.R. pt. 744).

[21] Whilst a more general decoupling of the United States and China is unlikely, there are sectors in which the relationship is thinning. *See* David Shambaugh, *U.S.-China Decoupling: How Feasible, How Desirable?,* CHINA-U.S. FOCUS (Dec. 6, 2019), https://www.chinausfocus.com/foreign-policy/us-china-decoupling-how-feasible-how-desirable [https://perma.cc/X62M-G8HB]; Yu Yongding, *The Decoupling Prophecy*, PROJECT SYNDICATE (Dec. 10, 2021), https://www.project-syndicate.org/commentary/china-wto-anniversary-no-economic-decoupling-by-yu-yongding-2021-12 [https://perma.cc/7P22-QJCY].

[22] The Cybersecurity Law, enacted in 2017, the Data Security Law, and the Personal Information Protection Law, both added in 2021, represent the formal legal responses, various fines, and other actions taken against firms, referenced in this Article. *See* Ngoc Son Bui & Jyh-An Lee, *Comparative Cybersecurity Law in Socialist Asia*, 55 VAND. J. TRANSNAT'L L. 631, 633–64, 653 (2022).

[23] *See* Susan Landau, *Making Sense from Snowden: What's Significant in the NSA Surveillance Revelations*, 11 IEEE SEC. & PRIV. 54, 59 (2013).

signs that China is looking within for future funding of innovation,[24] as well as striving to end problematic reliance on foreign innovation, particularly in semiconductors.[25] 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.[26]

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.[27] It outlines the Chinese political context, the rise of nonstate firms and their reasons for listing in the United States.[28] 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.[29] 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.[30] 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.[31] Part IV considers broader implications and highlights that the HFCAA is not the only factor leading to possible delistings.[32] Other factors

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[24] *China Is Trying to Protect Its Economy from Western Pressure*, THE ECONOMIST (May 25, 2022), https://www.economist.com/briefing/2022/05/26/china-is-trying-to-protect-its-economy-from-western-pressure [https://perma.cc/8EM3-G94W]; Kevin Yao, *China Pursues Economic Self-Reliance as External Risks Grow: Advisers*, REUTERS (Aug. 5, 2020, 7:13 PM), https://www.reuters.com/article/us-china-economy-strategy/china-purs%E2%80%A6conomic-self-reliance-as-external-risks-grow-advisers-idUSKCN25031K [https://perma.cc/3N6L-DADW].

[25] Dan Wang, *China's Sputnik Moment?*, FOREIGN AFFS. (July 29, 2021), https://www.foreignaffairs.com/articles/united-states/2021-07-29/chinas-sputnik-moment [https://perma.cc/AQD2-Z27G].

[26] Ravi Agrawal, A*merica's Risky New China Policy*, FOREIGN AFFS. (Nov. 2, 2022, 11:12 AM), https://foreignpolicy.com/2022/11/02/united-states-china-semiconductor-imports/ [https://perma.cc/RJQ5-757Z].

[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.[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.[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.[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.[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.[37] There has been increased regulation of data security,[38] monopolies and "disorderly expansion of capital,"[39] and rules regarding foreign listings.[40] Rather

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[33] *See infra* Part IV.

[34] *See* Margaret Pearson et al., *Party-State Capitalism in China*, 120 CURRENT HIST. 207, 207–08 (2021) [hereinafter Pearson et al., *Party-State Capitalism*].

[35] *Id.*

[36] Jude Blanchette, *Chinese State Capitalism: Introduction*, CTR. STRATEGIC & INT'L STUDS., Oct. 2021, at 2.

[37] *See* Wendy Leutert & Sarah Eaton, *Chinese State Capitalism: A New "Xi Era" in China's State-Owned Economy?*, CTR. STRATEGIC & INT'L STUDS., Oct. 2021, at 18–19.

[38] Rogier Creemers & Graham Webster, *Translation: Cybersecurity Review Measures (Revised)—Effective Feb. 15, 2022*, STAN. UNIV.: DIGICHINA (Jan. 10, 2022), https://digichina.stanford.edu/work/translation-cybersecurity-review-measures-revised-effective-feb-15-2022/ [https://perma.cc/DAM4-TZBZ].

[39] Lu Min Zhou Lin (陆 敏 周 琳), *Fángzhǐ Zīběn Wú Xù Kuòzhāng* (防止资本无序扩张) [*Prevent the Disorderly Expansion of Capital*], XINHUANET (Dec. 27, 2020), http://www.xinhuanet.com/2020-12/27/c_1126911793.htm [https:// perma.cc/3LZ3-9G8T] (China).

[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.[41] 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."[42] 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,[43] and the bold dynamic "zero COVID" approach that softened only in December 2022 following protests.[44]

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.[45] Nonstate firms have been seen to give rise to upstart entrepreneurs,[46] contribute to a housing bubble,[47]

Offering and Listing by Domestic Companies and Draft Administrative Measures for the Filing of Overseas Securities Offering and Listing by Domestic Companies. *See The CSRC Solicits Public Opinions on Rules Regarding Overseas Listings*, CHINA SEC. REGUL. COMM'N (Dec. 23, 2021), http://www.csrc.gov.cn/csrc_en/c102030/c1662393/content.shtml [https://perma.cc/Q8SD-2Q85].

[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.

[44] Michael Schuman, *Zero Covid's Failure Is Xi's Failure*, ATLANTIC (Dec. 10, 2022), https://www.theatlantic.com/international/archive/2022/12/zero-covids-failure-is-xi-jinpings-failure/672422/ [https://perma.cc/S74U-3YM4].

[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).

[46] Martin Miszerak, *China's Entrepreneurial Capitalism Faces a Grim Future*, E. ASIA F. (July 23, 2022), https://www.eastasiaforum.org/2022/07/23/chinas-entrepreneurial-capitalism-faces-a-grim-future/ [https://perma.cc/L75Y-PB44].

[47] Zhang Jing (张竞), *Xí Jìnpíng fāhuàle: Fángzi shì yòng lái zhù 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,[48] and CCP policies of common prosperity were reasserted, damaging share values.[49] 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.[50] 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.[51]

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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(Dec. 16, 2016, 8:29 PM), https://www.sohu.com/a/121802762_207224 [https://perma.cc/ABX6-VEUR].

[48] Sun Dan, *"Shuāng jiǎn"zhèngcè luòdì: Jiàng xiàowài péixùn xūhuǒ yánjìn zīběn huà yùnzuò* ("双减"政策落地:降校外培训虚火 严禁资本化运作) [The Implementation of the "Double Reduction" Policy: Reducing the False Fire of Off-Campus Training and Strictly Prohibiting Capitalized Operations] (经济参考报) [Economic Information Daily] (July 26, 2021, 7:34 AM), http://www.ce.cn/xwzx/gnsz/gdxw/202107/26/t20210726_36749743.shtml [https://perma.cc/6BEQ-USZ5]; Y-Ling Liu, *The Larger Meaning of China's Crackdown on School Tutoring*, NEW YORKER (May 16, 2022), https://www.newyorker.com/culture/culture-desk/the-larger-meaning-of-chinas-crackdown-on-school-tutoring [https://perma.cc/SS3W-UNBW]; Tim Culpan, *Capitalists Are No Longer Welcome in China's Classrooms*, BLOOMBERG (July 27, 2021, 12:30 AM), https://www.bloomberg.com/opinion/articles/2021-07-26/china-squeezes-the-profit-from-education-upending-the-private-tutoring-sector [https://perma.cc/6GNT-YNNC].

[49] Sofia Horta e Costa, *China Is Pariah for Global Investors as Xi's Policies Backfire*, BLOOMBERG (July 18, 2022, 5:34 AM), https://www.bloomberg.com/news/articles/2022-07-17/china-is-pariah-for-global-investors-as-xi-s-policies-backfire [https://perma.cc/JZ38-6EEM].

[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.[52] The attraction of IPOs on foreign exchanges such as the New York Stock Exchange (NYSE) included the possibility of both higher valuations[53] than could be achieved through domestic listings and a large global institutional investor base.[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.[55] Greater political freedom has also been identified as lowering the cost of capital.[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,[57] and this inevitably raises the cost of capital.[58] More intervention minimizes liquidity and increases market volatility.[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.[60]

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[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).

[53] *Id.* at 1831.

[54] George Calhoun, *Why Do Chinese Companies List Their Shares in New York?*, FORBES (Aug. 14 2020, 11:49 PM), https://www.forbes.com/sites/George calhoun/2020/08/14/why-do-chinese-companies-list-their-shares-in-new-york /?sh=2f1c80ae1f1b [https://perma.cc/F7DG-7GT7].

[55] Donald C. Clarke, *The Bonding Effect in Cross-Listed Chinese Companies: Is It Real*, *in* ENF'T OF CORP. AND SEC. LAW: CHINA AND THE WORLD 88 (Nicholas Calcina Howson & Robin Huang eds., 2017).

[56] Yaxuan Qi et al., *Political Rights and the Cost of Debt*, 95 J. FIN. ECON. 202, 222 (2010).

[57] Francis Fukuyama, *Reflections on Chinese Governance*, 1 J. CHINA GOV. 379, 387–88 (2016).

[58] OFF. OF THE SEC'Y OF STATE, THE ELEMENTS OF THE CHINA CHALLENGE 5 (December 2020), https://www.state.gov/wp-content/uploads/2020/11/20-02832 -Elements-of-China-Challenge-508.pdf [https://perma.cc/7T35-QSCY].

[59] Fabio Cortes et al., *Market Liquidity Strains Signal Heightened Global Financial Stability Risk*, IMF BLOG (Oct. 27, 2022), https://www.imf.org/en /Blogs/Articles/2022/10/26/market-liquidity-strains-signal-heightened-global -financial-stability-risk [https://perma.cc/6LZK-H2SE].

[60] Jing Yang, *'The Gold Standard': Why Chinese Startups Still Flock to the U.S. for IPOs*, WALL ST. J. (Aug. 13, 2020, 4:25 PM), https://www.wsj.com/arti

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,[61] although the level of capitalizations was down from record investment levels in 2021.[62] 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.[63] As noted, the looming threat of the HFCAA has abated somewhat as an agreement regarding audit inspections has been reached,[64] and there have been two successful inspections of audit firms,[65] 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.[66]

cles/the-gold-standard-why-chinese-startups-still-flock-to-the-u-s-for-ipos-11597313278 [https://perma.cc/GL5Y-2GXW].

[61] U.S.-CHINA ECON. & SEC. REV. COMM'N, *supra* note 2.

[62] Echo Wang & Abhinav Ramnarayan, *Analysis: Record IPO Binge in 2021 Leaves Investors Hung Over*, REUTERS (Dec. 24, 2021, 12:50 PM), https://www.reuters.com/markets/europe/record-ipo-binge-2021-leaves-investors-hung-over-2021-12-24/ [https://perma.cc/5D2C-ZWRS].

[63] U.S.-CHINA ECON. & SEC. REV. COMM'N, *supra* note 2.

[64] PUB. CO. ACCT. OVERSIGHT BD, *supra* note 10.

[65] Stephen Foley, *US Regulators Gain Access to Audits of Chinese Companies*, FIN. TIMES (Dec. 15, 2022), https://www.ft.com/content/2dcc601a-2299-49b0-9f83-c0d4d6be2e84 [https://perma.cc/6WPY-B7N3].

[66] SOEs have evolved markedly as many emerged from the planned economy in poor shape and policies aimed to "grasp the large, let go of the small[,]" with many being closed or privatized and others successfully growing under state control. Chang-tai Hsieh & Zheng Michael Song, *Grasp the Large, Let Go of the Small: The Transformation of the State Sector in China*, BROOKINGS PAPERS ON ECON. ACTIVITY, at 7, 12 (March 2015), https:// www.brookings.edu/wp-content/uploads/2016/07/2015a_hsieh.pdf [https://perma.cc/2UDH-VDGF]. Significant reforms to Chinese state-owned enterprises have left this sector in

B. The Rise of Private Companies

The strength of the nonstate sector is reflected in the popular number combination of 60/70/80/90.[67] 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."[68] 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"[69] in the pursuit of China's technological ambitions.[70] 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].

[67] Amir Guluzade, *The Role of China's State-Owned Companies Explained*, WORLD ECON. F. (May 7, 2019), https://www.weforum.org/agenda/2019/05/why-chinas-state-owned-companies-still-have-a-key-role-to-play/ [https://perma.cc/ZJC3-9M7T].

[68] *Id.*

[69] Michael Hirson, *State Capitalism and the Evolution of "China, Inc.": Key Policy Issues for the United States Testimony before the U.S.-China Economic and Security Review Commission on "China's Internal and External Challenges"*, U.S.-CHINA ECON. & SEC. REV. COMM'N (Feb. 7, 2019), https://www.uscc.gov/sites/default/files/Hirson_USCC%20Testimony_FINAL.pdf [https://perma.cc/ZER4-MJDG].

[70] *See* Max J. Zenglein & Anna Holzmann, *Evolving Made in China 2025: China's Industrial Policy in the Quest for Global Tech Leadership*, 8 MERICS 1, 43–44 (2019); Shang-Jin Wei et al., *From "Made in China" to "Innovated in China": Necessity, Prospect, and Challenges*, 31 J. ECON. PERSP. 49, 53 (2017).

developed technologies[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.[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.[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.[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,[75] and undermine "common prosperity."[76]

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[71] Reflected in a statement of Premier Li Keqiang at a symposium of the Ministry of Industry and Information Technology, June 15, 2015: 传统的"MADE IN CHINA"我们还要做，但"中国制造 2025"的核心，应该是主打"中国装备"。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].

[72] Hudson Lockett, *How Xi Jinping Is Reshaping China's Capital Markets*, FIN. TIMES (June 12, 2022), https://www.ft.com/content/d5b81ea0-5955-414c-b2eb-886dfed4dffe [https://perma.cc/3EK3-2L59].

[73] Jeanny Yu, *China's New Crackdown Shows $1.5 Trillion Tech Rout Not Over Yet*, BLOOMBERG (Feb. 19, 2022, 7:00 PM), https://www.bloomberg.com/news/articles/2022-02-19/china-s-new-crackdown-shows-1-5-trillion-tech-rout-not-over-yet#xj4y7vzkg [https://perma.cc/DZC2-W3S8].

[74] Yiping Huang, *'Strong Regulations' of China's Platform Economy: A Preliminary Assessment,* 15 CHINA ECON. J. 125, 126–27 (2022).

[75] XINHUA, *The Political Bureau of the CPC Central Committee held a meeting chaired by Xi Jinping* (Dec. 11, 2020, 6:28 PM), http://www.xinhuanet.com/politics/leaders/2020-12/11/c_1126850644.html [https://perma.cc/8BN9-SN6Z]; Zichen Wang, *Politburo Meeting Calls for "Reinforcing Anti-monopoly and Prevent Capital from Expanding in a Disorderly Fashion"*, PEKINGNOLOGY (Dec. 11, 2020), https://pekingnology.substack.com/p/politburo-meeting-calls-for-reinforcing [https://perma.cc/73SP-UVE3].

[76] Xin Sun, *Decoding China's 'Common Prosperity' Drive*, MEDIUM: LSE IDEAS (Apr. 7, 2022), https://lseideas.medium.com/decoding-chinas-common-prosperity-drive-4d98a127bfb0 [https://perma.cc/3TFA-HFYF].

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,

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[77] Emily Feng, *A Top Chinese Ride-Hailing Company Delists From the NYSE Just Months After Its IPO*, NPR (Dec. 3, 2021, 12:47 PM), https://www.npr.org/2021/12/03/1061219965/a-top-chinese-tech-company-delists-from-the-nyse-just-months-after-its-ipo [https://perma.cc/8QGA-8E7V]. The high-profile action against Jack Ma and Alibaba Group, in which an intended IPO was blocked, is treated as outside the period under discussion, having been ongoing since 2020. Arjun Kharpal, *Alibaba Shares Drop 8% After Jack Ma's Ant Group and Regulator Squash Talk of Revived IPO*, CNBC (June 9, 2022, 6:54 PM), https://www.cnbc.com/2022/06/09/alibaba-shares-drop-after-jack-mas-ant-group-says-no-plan-for-ipo.html#:~:text=Ant%20Group%2C%20founded%20by%20billionaire,not%20on%20the%20cards%20yet [https://perma.cc/T2S8-7Q7Z].

[78] Kate Conger & Raymond Zhong, *Didi, the Chinese Ride-Hailing Giant, Makes Its Debut on Wall Street*, N.Y. TIMES (Aug. 27, 2021), https://www.nytimes.com/2021/06/30/technology/didi-wall-street-initial-public-offering.html [https://perma.cc/CS7S-GBGX].

[79] Raymond Zhong, *China Orders Didi Off App Stores in an Escalating Crackdown*, N.Y. TIMES (Aug. 27, 2021), https://www.nytimes.com/2021/07/04/technology/china-didi-app-removed.html [https://perma.cc/22WF-ZG7R].

[80] Erol Yayboke et al., *The Real National Security Concerns over Data Localization*, CSIS BRIEFS (July 23, 2021), https://www.csis.org/analysis/real-national-security-concerns-over-data-localization [https://perma.cc/K6BC-2UTD].

[81] Yoko Kubota, *In the New China, Didi's Data Has Become a Problem*, WALL ST. J. (July 18, 2021, 7:00 AM), https://www.wsj.com/articles/in-the-new-china-didis-data-becomes-a-problem-11626606002 [https://perma.cc/RS27-HEL3].

[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 Didi[85] 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

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[83] Corrie Driebusch, *Didi Global Prices IPO at $14 a Share*, WALL ST. J. (June 30, 2021, 10:19 AM), https://www.wsj.com/articles/didi-ipo-pricing-imminent-after-lightning-round-roadshow-11624987451 [https://perma.cc/43CC-94LQ].

[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.*

[88] *See* Zhonghua renmin gongheguo shuju anquan fa (中华人民共和国数据安全法) [Data Security Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., June 10, 2021, effective July 1, 2021) 2021 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ., http://www.npc.gov.cn/englishnpc/c23934/202112/1abd8829788946ecab270e469b13c39c.shtml [https://perma.cc/Q6GE-LD6C].

[89] *See* Josh Horwitz & Yilei Sun, *Explainer: What is driving China's clampdown on Didi and data security?*, REUTERS (July 7, 2021, 8:16 AM), https://www.reuters.com/technology/what-is-driving-chinas-clampdown-didi-data-security-2021-07-07/ [https://perma.cc/2A6N-MDVC].

[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 Weibo[94] 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,

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[91] *See* Jing Yang, *Didi Global Plans to Delist From New York Stock Exchange*, WALL ST. J. (Dec. 3, 2021, 7:54 AM), https://www.wsj.com/articles/didi-global-plans-to-delist-from-new-york-stock-exchange-11638495158 [https://perma.cc/G7RU-FAC4].

[92] Ant Financial was a Fintech group, now renamed Ant Group. *See* James Kynge et al., *'The Party Is Pushing Back': Why Beijing Reined in Jack Ma and Ant*, FIN. TIMES (Nov. 4, 2020), https://www.ft.com/content/3d2f174d-aa73-44fc-8c90-45c2a554e97b [https://perma.cc/H2SS-PUHZ].

[93] Tencent is a technology and entertainment conglomerate. *See* Q.ai, *Alibaba And Tencent Fined In China Tech Crackdown*, FORBES (July 13, 2022), https://www.forbes.com/sites/qai/2022/07/13/alibaba-and-tencent-fined-in-china-tech-crackdown/?sh=5722aada3dac [https://perma.cc/7TVE-2ZF5].

[94] Weibo is a social media platform. *See* Liza Lin, *China Fines Weibo for Spreading 'Illegal Information'*, WALL ST. J. (Dec. 14, 2021, 6:42 AM), https://www.wsj.com/articles/china-fines-weibo-for-spreading-illegal-information-11639482120 [https://perma.cc/8A67-6QJU].

[95] For a nuanced explanation of the concept of common prosperity, see Sun, *supra* note 76.

[96] *See, e.g.*, Culpan, *supra* note 48.

[97] *See* FIN. ACCT. STANDARDS BD., SUMMARY OF INTERPRETATION NO. 46 (2003), https://www.fasb.org/page/PageContent?pageId=/reference-library/superseded-standards/summary-of-interpretation-no-46.html [https://perma.cc/NF6W-7FLF].

[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[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:

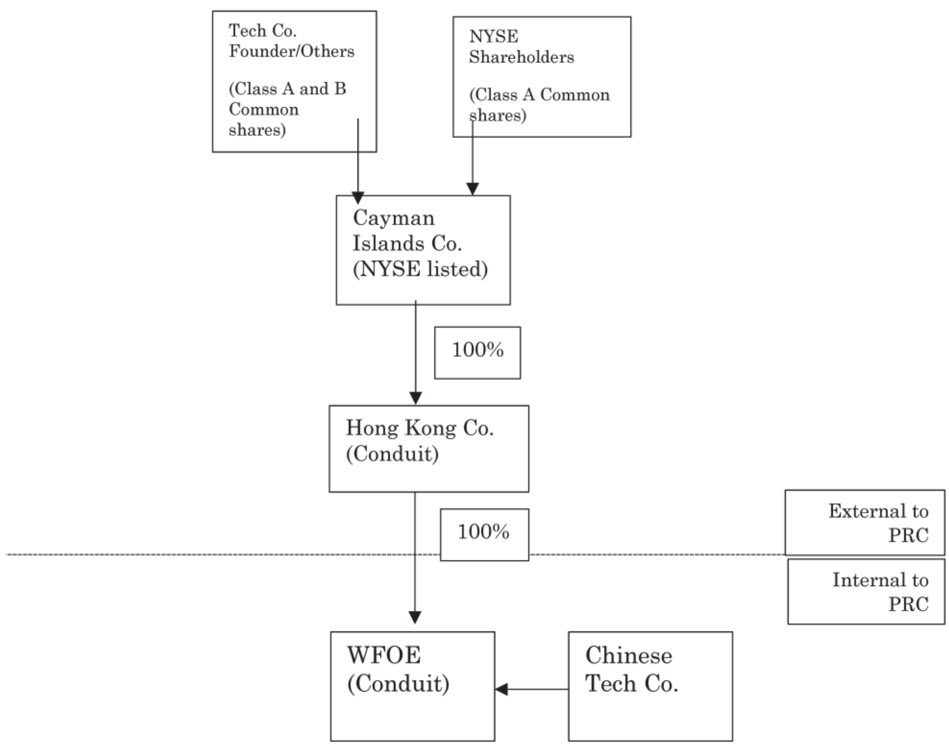

FIGURE 1

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

[99] *See* Jing Yang, *U.S. and Chinese Regulators Are in a Bind Over a Three-Letter Acronym*, WALL ST. J. (Sep. 30, 2021, 6:50 AM), https://www.wsj.com/articles/u-s-and-chinese-regulators-are-in-a-bind-over-a-three-letter-acronym-11632999033 [https://perma.cc/36PN-CZB9].

[100] *See generally* Fa Chen, *Variable Interest Entity Structures in China: Are Legal Uncertainties and Risks to Foreign Investors Part of China's Regulatory Policy?*, 29 ASIA PAC. L. REV. 1 (2021).

company in the Cayman Islands.[101] 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).[102] 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.[103] 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.[104] This model of precarious legal structure underpins many of the biggest U.S. listings.[105] Nearly all the big data platforms have dual-class shareholdings and VIE structures.[106] 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.[107] They operate in a regulatory grey zone, where an investor does not have a controlling stake

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[101] *See* Kate Hodson & David Nelson, *The Future of Cayman Vehicles in Asian Structures*, OGIER (Feb. 18, 2019), https://www.ogier.com/publications/the-future-of-cayman-vehicles-in-asian-structures [https://perma.cc/VX3F-W8TR].

[102] *See supra* Figure 1.

[103] *See* W. Tyler Perry, Note, *Development and Distrust: A Critique of the Orthodox Path to Economic Prosperity*, 110 NW. U. L. REV. 477, 482–83 (2016).

[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].

[105] *See* Serena Shi, *Dragon's House of Cards: Perils of Investing in Variable Interest Entities Domiciled in the People's Republic of China and Listed in the United States*, 37 FORDHAM INT'L LAW J. 1265, 1307 (2014).

[106] *See* Zinnia Lee, *China's Cybersecurity Regulator Targets More U.S.-Listed Tech Companies After Didi Investigation*, FORBES (July 5, 2021, 7:46 AM), https://www.forbes.com/sites/zinnialee/2021/07/05/chinas-cybersecurity-regulator-targets-more-us-listed-tech-companies-after-didi-investigation/?sh=c5a29e421a89 [https://perma.cc/QZ78-RBW8].

[107] *See* Eamon Barrett, *Beijing Might Finally Close the IPO Loophole that Allowed Didi to List Overseas*, FORTUNE (July 8, 2021, 6:57 AM), https://fortune.com/2021/07/08/beijing-loophole-vie-overseas-ipo-didi-crackdown/ [https://perma.cc/N3LG-PUUQ].

but retains a controlling interest,[108] with the potential for agency problems as well as precarity.[109] The approach of the HFCAA to improve clarity for investors is considered in Part III.

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.[110] 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.[111] 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.[112] For instance, the Didi IPO went ahead despite requests for a delay from the State Administration for Market Regulation (SAMR).[113]

The VIE structure bypasses other aspects of the Chinese laws besides the restrictions on foreign investment.[114] Regulatory requirements for IPOs in China are more stringent than those

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[108] *See* Waishang touzi chanye zhidao mulu (外商投资产业指导目录) [Catalogue for the Guidance of Foreign Investment Industries] (promulgated by the Ministry of Com., Feb. 21, 2012), http://english.mofcom.gov.cn/article/policyrelease/aaa/201203/20120308027837.shtml [https://perma.cc/D4FS-D8M7]; *see also* Roberto Sanchez, *Chinese VIE Structure: Wall Street Continues to Ignore the Risks*, GCI INVESTORS (Nov. 10, 2020), https://gci-investors.com/chinese-vie-structure-wall-street-continues-to-ignore-the-risks/ [https://perma.cc/MJ4J-389G].

[109] *See* Justin Hopkins et al., *The Rise of US Listed VIEs from China: Balancing State Control and Access to Foreign Capital* 8 (Darden Bus. Sch. Working Paper No. 3119912, Kenan Inst. of Priv. Enter. Rsch. Paper No. 19-17, 2018).

[110] *See* Brandon Whitehill, *Buyer Beware: Chinese Companies and the VIE Structure*, COUNCIL OF INST. INVESTORS, at 6 (2017).

[111] *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).

[112] *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].

[113] *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].

[114] *See* Chen, *supra* note 100, at 15, 18.

imposed by U.S. regulators.[115] China has much tougher listing requirements, like requisite profits, and a long and uncertain waiting period for regulatory approval.[116] Chinese regulators require companies to have solid cash flow and earnings for listing on the domestic market, known as the A shares market.[117] The structure has therefore played a big role in the rise of the Chinese platform companies in enabling easier access to capital.[118]

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.[119] Furthermore, the *Antitrust Guidelines for the Platform Economy* came into effect after the abrupt suspension of Ant Group's IPO on February 7, 2021.[120] The SAMR was empowered to oversee mergers and acquisitions conducted by VIEs.[121] 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.[122] 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.

[116] *See* Zhonghua renmin gongheguo zhengquan fa (中华人民共和国证券法) [Securities Law of the People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., December 28, 2019, effective March 1, 2020) 2019 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. art. 47, http://www.npc.gov.cn/englishnpc/c23934/202109/9886ca6f805e4663a9a725d6f72066dd.shtml [https://perma.cc/7UMG-H259].

[117] *See* Jeff Sommer, *Invest in China, but Without Illusions*, N.Y. TIMES (July 23, 2021), https://www.nytimes.com/2021/07/23/business/china-stock-market-invest.html [https://perma.cc/U6U9-M7NK].

[118] *See id.*

[119] *See* Aynne Kokas, *Platform Patrol: China, the United States, and the Global Battle for Data Security*, 77 J. ASIAN STUD. 923, 927–28 (2018).

[120] *See* Wei Huang et al., *Antitrust Guidelines for the Platform Economy in the Era of Enhanced Antitrust Scrutiny*, CPI ANTITRUST CHRON., Mar. 2021, at 2.

[121] *See id.*

[122] *See* Matt Levine, *Money Stuff: Owning Chinese Companies Is Complicated*, BLOOMBERG (July 7, 2021, 12:55 PM), https://www.bloomberg.com/news/newsletters/2021-07-07/money-stuff-owning-chinese-companies-is-complicated [https://perma.cc/VL2P-4TST].

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.

[124] *See* Anna Gamvros & Lianying Wang, *"Am I a CII Operator?"—New Regulation in China Provides More Clarity*, NORTON ROSE FULBRIGHT (Aug. 18, 2021), https://www.dataprotectionreport.com/2021/08/am-i-a-cii-operator-new-regulation-in-china-provides-more-clarity/ [https://perma.cc/4GL8-H8GD].

[125] *See* Lingling Wei, *China's Cyber Watchdog to Police Chinese Overseas Listings*, WALL ST. J. (July 8, 2021, 7:04 AM), https://www.wsj.com/articles/chinas-cyber-watchdog-to-police-chinese-overseas-listings-11625742254 [https://perma.cc/W3ZA-DR93].

[126] *See infra* Section II.A.

[127] Qingxiu Bu, *The Anatomy of Holding Foreign Companies Accountable Act (HFCAA): A Panacea or a Double-Edge Sword?,* 16 CAP. MKTS. L.J. 503, 510 (2021).

[128] *See* Kiuyan Wong & Benjamin Bain, *What's Driving the US-China Spat Over Audits and Delisting*, BLOOMBERG (Aug. 26, 11:56 PM), https://www.bloomberg.com/news/articles/2022-07-28/what-s-driving-us-china-spat-over

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.[129] 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,[130] and the infiltration of Huawei's servers.[131] Ideologically, a deep-seated, related perception is that the Public Company Accounting Oversight Board (PCAOB)'s auditing inspections, enforced under the HFCAA,[132] would facilitate the United States' espionage against China's economic and national security, leading to the leakage of sensitive data.[133] In the example of Didi there were concerns that the firm's onshore mapping data would be at risk of falling into foreign hands.[134] China assumes that hostile foreign states may use such data to subvert the Chinese government, launch cyberattacks, disrupt supply chains and endanger national security.[135]

As such, the Chinese government has been willing to incur significant decoupling costs in order to exert political control,[136] another illustration that party-state capitalism inherently involves

-audits-delistings-quicktake?leadSource=uverify%20wall [https://perma.cc/V9EY-HS6W].

[129] *See, e.g.*, Exec. Order No. 13,959, 31 C.F.R. pt. 586, app. A (2020).

[130] *See* Susan Landau, *Making Sense from Snowden: What's Significant in the NSA Surveillance Revelations*, 11 IEEE SEC. & PRIV. 54, 59 (2013).

[131] Pearson et al., *Party-State Capitalism*, *supra* note 34, at 209.

[132] 15 U.S.C. § 7214 (2020).

[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].

[134] Yoko Kubota, *In the New China, Didi's Data Has Become a Problem*, WALL ST. J. (July 18, 2021, 7:00 AM), https://www.wsj.com/articles/in-the-new-china-didis-data-becomes-a-problem-11626606002 [https://perma.cc/DH3A-XH5W].

[135] Jane Perlez & Paul Mozur, *Mutual Suspicion Mars Tech Trade With China*, N.Y. TIMES (Feb. 27, 2015), https://www.nytimes.com/2015/02/28/technology/in-china-suspicions-cloud-trade-dispute-involving-tech-companies.html [https://perma.cc/PB3Y-FMSB].

[136] Josh Bramble, *Beijing's Tech Sector Crackdown Sends a Clear Warning to Companies Going Global*, CTR. STRATEGIC & INT'L STUDS. (Oct. 4, 2021), https://www.csis.org/blogs/new-perspectives-asia/beijings-tech-sector-crackdown-sends-clear-warning-companies-going [https://perma.cc/KAV4-6K3E].

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 control[138] and this is the case for data sovereignty too.[139] Under the Beijing Model, a firm's data sovereignty is crucial for attracting investor capital[140] 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

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[137] *See* Daniel Rosen, *China's Economic Reckoning*, 110 FOREIGN AFFS. 24, 29 (2021).

[138] U.S.-CHINA & SEC. REV. COMM'N, REP. TO CONG., at 133 (2021), https://www.uscc.gov/sites/default/files/2021-11/2021_Annual_Report_to_Congress.pdf [https://perma.cc/8UM6-S44K].

[139] *Id.* at 135.

[140] John Hyatt, *Why the Didi Drama Is Flashing A Warning Sign to U.S. Investors*, NASDAQ (July 6, 2021, 10:42 AM), https://www.nasdaq.com/articles/why-the-didi-drama-is-flashing-a-warning-sign-to-u.s.-investors-2021-07-06 [https://perma.cc/4NE2-ECAF].

[141] *See* [National Intelligence Law] (promulgated by the Standing Comm. Nat'l People's Cong. June 27, 2017, effective June 28, 2017) art. 7, 2017 P.R.C. LAWS (China); [National Security Law] (promulgated by the Standing Comm. Nat'l People's Cong. July 1, 2015, effective July 7, 2015) art. 77, 2015 P.R.C. LAWS (China); [Cybersecurity Law] (promulgated by the Standing Comm. Nat'l People's Cong. Nov. 7, 2016, effective June 1, 2017) art. 28, 2017 P.R.C. LAWS (China) (empowering the government to request that online platform firms to assist with intelligence gathering); *see also* Pearson et al., *International Backlash*, *supra* note 41, at 150.

[142] U.S.-CHINA & SEC. REV. COMM'N, *supra* note 138, at 134.

[143] Erol Yayboke & Carolina G. Ramos, *The Real National Security Concerns over Data Localization*, CSIS BRIEFS (July 23, 2021), https://www.csis.org/analysis/real-national-security-concerns-over-data-localization [https://perma.cc/6QRD-UWPT].

[144] *See* Edward White & Sun Yu, *What Is China's 'Battle for Data' and Who Will Be Targeted Next?*, FIN. TIMES (July 29, 2021), https://www.ft.com/content/1282e529-ee65-4a8d-9190-c7d1eb70b8d5 [https://perma.cc/5YXQ-S29Z].

regulatory wave, the Cybersecurity Law, the Data Security Law, and the Personal Data Protection Law.

1. China Cybersecurity Law (CSL 2017)

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 CIIs 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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[145] *See, e.g.*, [Cybersecurity Law] (promulgated by the Standing Comm. Nat'l People's Cong. Nov. 7, 2016, effective June 1, 2017) art. 31, 2017 P.R.C. LAWS (China).

[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.*

[149] *See* [Critical Information Infrastructure Security Protection Regulations] (promulgated by the Standing Committee Meeting of the State Council on Apr. 27, 2021, effective Sep. 1, 2021) ST. COUNCIL GAZ. Aug. 17, 2021 (China).

[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),[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.[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.[154] The law is particularly concerned with cross-border data security and it restricts the collection of data that may harm national security.[155] The DSL 2021 prohibits enterprises from transferring "core state data" overseas without the approval of Chinese regulators.[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.[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.[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.[159] To this end, China has in the PDPL 2021 articulated a modern

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[152] Consolidated Appropriations Act, 2018, Pub. L. No. 115-141, §§ 101–106, 132 Stat. 348, 1213–25 (2018).

[153] *Id.* at 1214.

[154] [The Data Security Law] (promulgated by the Standing Comm. of the Nat'l People's Cong. June 10, 2021, effective Sept. 1, 2021) art. 21, 25, 2021 P.R.C. LAWS (China).

[155] *See id.* art. 8.

[156] *Id.* art. 36.

[157] *Id.* art. 36; *see infra* note 211 and accompanying text.

[158] [The Data Security Law] (promulgated by the Standing Comm. of the Nat'l People's Cong. June 10, 2021, effective Sept. 1, 2021), art. 46, 2021 P.R.C. LAWS (China).

[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

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[160] The EU General Data Protection Regulation (GDPR) went into effect on 25 May 2018, replacing the Data Protection Directive 95/46/EC. Council Regulation 2016/679, 2016 O.J. (L119) (EU).

[161] *See generally* [The Personal Data Protection Law] (promulgated by the Standing Comm. of the Nat'l People's Cong. Aug. 20, 2021, and came into effect on Nov. 1, 2021) 2021 P.R.C. LAWS (China).

[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].

[164] [The Personal Data Protection Law] (promulgated by the Standing Comm. of the Nat'l People's Cong. Aug. 20, 2021, effective on Nov. 1, 2021), art. 38(2), 2021 P.R.C. LAWS (China).

[165] *Id.* art. 40.

[166] *Id.* arts. 14–15.

[167] Yang & Yu, *supra* note 133.

[168] White & Yu, *supra* note 144.

AI.[169] 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

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[169] Lilian Edwards, *The EU AI Act: a Summary of Its Significance and Scope*, ADA LOVELACE INST. 7 (Apr. 11, 2022), https://www.adalovelaceinstitute.org/wp-content/uploads/2022/04/Expert-explainer-The-EU-AI-Act-11-April-2022.pdf [https://perma.cc/JR58-Q4TF].

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

[171] *See* Bingna Guo & Bob Li, *China Issued New Measures for Cybersecurity Review in 2022*, WHITE & CASE (Feb. 8, 2022), https://www.whitecase.com/insight-alert/china-issued-new-measures-cybersecurity-review-2022 [https://perma.cc/9VJA-DQAH].

[172] [Cybersecurity Review Measures] (Promulgated by Cyberspace Admin. of China, Feb. 15, 2022, effective Feb. 15, 2022), art. 7, 2022 P.R.C. LAWS (China), https://digichina.stanford.edu/work/translation-cybersecurity-review-measures-revised-effective-feb-15-2022/ [https://perma.cc/H6V4-AFG5].

[173] Draft Measure to Register Chinese Companies Issuing Securities or Going Public Abroad, art. 5 P.R.C. LAWS (China), http://www.csrc.gov.cn/csrc_en/c102030/c1662393/1662393/files/Administrative%20Measures%20for%20the%20Filing%20of%20Overseas%20Securities%20Offering%20and%20Listing%20by%20Domestic%20Companies__(Draft%20for%20Comments).pdf [https://perma.cc/EG9B-U8GF].

[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,[175] but complex cases can take ninety days and others can be extended beyond this.[176]

The Review Measures aim to provide a predictable framework for overseas listing.[177] It clarifies proceedings in a market rocked by the state's crackdown on overseas listings.[178] 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.[179] 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.[180] 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,[181] they should, however, reduce the risk for investments in those Chinese firms which do pass the screening process.[182]

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

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(China), https://digichina.stanford.edu/work/translation-cybersecurity-review-measures-revised-effective-feb-15-2022/ [https://perma.cc/H6V4-AFG5].

[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.

[180] *See* Powell, *supra* note 98; *see, e.g.*, Cybersecurity Review Measures (Promulgated by Cyberspace Admin. of China, Feb. 15, 2022, effective Feb. 15, 2022), Arts. 11–13, 2022 P.R.C. LAWS (China), https://digichina.stanford.edu/work/translation-cybersecurity-review-measures-revised-effective-feb-15-2022/ [https://perma.cc/H6V4-AFG5].

[181] *China Seems Intent on Decoupling Its Companies from Western Markets*, THE ECONOMIST (July 10, 2021) [hereinafter *Intent on Decoupling*], https://www.economist.com/business/2021/07/10/china-seems-intent-on-decoupling-its-companies-from-western-markets [https://perma.cc/3M2Z-A46H].

[182] *See* Bramble, *supra* note 136.

impact online platform firms.[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.[184] The new measures are set to significantly delay the listing process and add uncertainties.[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.[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.[187] These challenges have also rendered it difficult for Chinese firms to raise capital under stringent restrictions on overseas IPOs.[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.[189] Amidst the ongoing turmoil, many tech firms have reportedly shelved their overseas IPO plans.[190] For instance, ByteDance reportedly decided to delay its IPO efforts over concerns stemming from data security risks.[191]

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[183] [Outbound Data Transfer Security Assessment Measures] (promulgated by the Cyberspace Admin. China July 7, 2022, effective Sept. 1, 2022) arts. 2–4 P.R.C. LAWS https://digichina.stanford.edu/work/translation-outbound-data-transfer-security-assessment-measures-effective-sept-1-2022/ [https://perma.cc/S93Z-XEAF].

[184] [Cybersecurity Review Measures] (Promulgated by Cyberspace Admin. China, Feb. 15, 2022, effective Feb. 15, 2022), art. 7, 2022 P.R.C. LAWS (China), https://digichina.stanford.edu/work/translation-cybersecurity-review-measures-revised-effective-feb-15-2022/ [https://perma.cc/H6V4-AFG5].

[185] *See* Guo & Li, *supra* note 171.

[186] *See, e.g.*, ANDREW COLLIER, CHINA'S TECHNOLOGY WAR: WHY BEIJING TOOK DOWN ITS TECH GIANTS 46–68 (2022).

[187] Bramble, *supra* note 136.

[188] *See id.*

[189] *See* Vivien Chu et al., *China Issues Revised Measures on Cybersecurity Review Over Network Operators*, JDSUPRA (Jan. 25, 2022), https://www.jdsupra.com/legalnews/china-issues-revised-measures-on-2737532/ [https://perma.cc/LD9A-6538].

[190] *See, e.g.*, Xie Yu & Lisa Lin, *ByteDance Shelved IPO Intentions After Chinese Regulators Warned About Data Security*, WALL ST. J. (July 12, 2021, 4:20 AM), https://www.wsj.com/articles/bytedance-shelvedipo-intentions-after-chinese-regulators-warned-about-data-security-11626078000 [https://perma.cc/JG36-DD92].

[191] *See id.*

2. *Ex Post Mandatory Requirements*

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

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[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).

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

[194] *See, e.g.*, [Outbound Data Transfer Security Assessment Measures] (promulgated by the Cyberspace Admin. China July 7, 2022, effective Sept. 1, 2022) art. 1 P.R.C. LAWS https://digichina.stanford.edu/work/translation-outbound-data-transfer-security-assessment-measures-effective-sept-1-2022/ [https://perma.cc/S93Z-XEAF].; [Cybersecurity Review Measures] (Promulgated by Cyberspace Admin. China, Feb. 15, 2022, effective Feb. 15, 2022), art. 14, 2022 P.R.C. LAWS (China), https://digichina.stanford.edu/work/translation-cybersecurity-review-measures-revised-effective-feb-15-2022/ [https://perma.cc/H6V4-AFG5].

[195] *See, e.g.*, [Outbound Data Transfer Security Assessment Measures] (promulgated by the Cyberspace Admin. China July 7, 2022, effective Sept. 1, 2022) arts. 6,8,9, P.R.C. LAWS (China), https://digichina.stanford.edu/work/translation-outbound-data-transfer-security-assessment-measures-effective-sept-1-2022/ [https://perma.cc/S93Z-XEAF].

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

[197] Nigel Cory & Luke Dascoli, *How Barriers to Cross-Border Data Flows Are Spreading Globally, What They Cost, and How to Address Them*, INFO. TECH. & INNOVATION FOUND. (July 19, 2021), https://itif.org/publications/2021/07/19/how-barriers-cross-border-data-flows-are-spreading-globally-what-they-cost [https://perma.cc/J96E-JZYQ].

[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.[199] 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.[200] A positive side effect is that the stricter oversight of overseas listings may improve the regulatory framework for companies listing shares overseas.[201] 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.[202]

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[203] 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.[204] Second, the HFCAA also requires information regarding ownership or control of a firm by a foreign government, addressing

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[199] *See, e.g.*, Amy Yin et al., *China Imposes Largest Data Protection Penalty*, REED SMITH (July 29, 2022), https://www.reedsmith.com/en/perspectives/2022/07/china-imposes-largest-data-protection-penalty#:~:text=(Didi%20Global)%2C%20the%20Cyberspace,data%20protection%20case%20in%20China [https://perma.cc/HH3K-DSCT].

[200] *See, e.g.*, Alexandra Stevenson, *Five State-Run Chinese Giants to Delist From U.S. Stock Exchanges*, N.Y. TIMES (Aug. 12, 2022), https://www.nytimes.com/2022/08/12/business/china-us-delisting-stock-exchange.html [https://perma.cc/7BFW-VB4V].

[201] *See, e.g.*, Bramble, *supra* note 136.

[202] *See, e.g.*, (中共中央办公厅 国务院办公厅印发《关于依法从严打击证券违法活动的意见》) [Opinions on Strictly Cracking down on Illegal Securities Activities in accordance with the Law] (Promulgated by the Gen. Office of the Cent. Comm. of the Communist Party of China, July 6, 2021), http://www.gov.cn/zhengce/2021-07/06/content_5622763.htm [https://perma.cc/3N84-TFCA] (China).

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

[204] 15 U.S.C. § 7214(i)(3)(A).

concerns of Chinese state control of nonstate firms.[205] Thirdly, it also addresses the problems of VIEs.[206] 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.[207] Yet the use of these VIE vehicles has been opaque for investors and the HFCAA requires greater clarity.[208]

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).[209] 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.[210] There has been a deadlock as Chinese companies are prohibited from compliance under state secrecy provisions[211] and so neither ULCCs nor subsidiaries of the Big Four firms[212] in China have been allowed to share their audit papers with the PCAOB.[213] The

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[205] *Id.* § 7214(i)(2)(B).

[206] Holding Foreign Companies Accountable Act Disclosure Release No. 34-91364, 86 Fed. Reg. 70,027, 70,031 (Apr. 5, 2021).

[207] *See supra* notes 97–98 and accompanying text.

[208] *See supra* note 7 and accompanying text.

[209] Simon Chan et al., *Holding Foreign Companies Accountable Act—The Impact on Chinese Companies Listed on U.S. Stock Exchanges*, JDSUPRA (Nov. 10, 2022), https://www.jdsupra.com/legalnews/holding-foreign-companies-accountable-2379381/ [https://perma.cc/QF4Y-KB4Z].

[210] Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 104(a), 116 Stat. 745, 757 (2002).

[211] [Law of the People's Republic of China on Guarding State Secrets] (promulgated by the Standing Comm. of the Seventh Nat'l People's Cong., Sept. 5, 1988, rev'd Apr. 29, 2010, effective Oct. 1, 2010, art. 28, 2021 P.R.C. LAWS (China).

[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-5S9R]. 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.[214] Most notably, Luckin Coffee, a New York–listed firm, had admitted to fabricating over $310 million of its sales,[215] contributing to the HFCAA backlash.[216] The frauds also damaged the ULCCs' international image and adversely affected their overseas financing.[217] The effect of PCAOB non-compliance has been estimated as a 5–7% valuation haircut for Chinese firms associated with negative publicity.[218]

The HFCAA process is for the SEC to identify any issuers who are in default, based on determinations by the PCAOB.[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.[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[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.[222]

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[214] *See id.*

[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-77a21675fef6 [https://perma.cc/KAV9-Y39U].

[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-ecd2-4855-8193-d0550f1d2e3d [https://perma.cc/G9SJ-V9D8].

[217] George Calhoun, *Didi Means War—A Financial Cold War with China*, FORBES (July 19, 2021), https://www.forbes.com/sites/georgecalhoun/2021/07/19/didi-means-war-a-financial-cold-war-with-china/?sh=7572aa465ce7 [https://perma.cc/K5LP-RFGB].

[218] *Id.*

[219] *Id.*

[220] *Holding Foreign Companies Accountable Act*, SEC (Jan. 9, 2023), https://www.sec.gov/hfcaa [https://perma.cc/98YA-3FQA].

[221] *Id.*

[222] Holding Foreign Companies Accountable Act, Pub. L. No. 116-222, 134 Stat. 1063, 1063–64 (2020) (amending Section 104 of the Sarbanes-Oxley Act of 2002, 15 U.S.C. § 7214).

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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[223] *CSRC Officials Answered Reporter Question*, CHINA SEC. REG. COMM'N (Mar. 10, 2022), http://www.csrc.gov.cn/csrc_en/c102030/c2052837/content.shtml [https://perma.cc/8LJB-JR4S].

[224] *Id.*

[225] Yingzhi Yang et al., *Chinese Regulators Ask Some U.S.-Listed Firms to Prepare for Audit Disclosures*, REUTERS (Mar. 23, 2022, 9:16 PM), https://www.reuters.com/business/exclusive-chinese-regulators-ask-some-us-listed-firms-prepare-audit-disclosures-2022-03-23/ [https://perma.cc/UG4L-PWEW].

[226] PUB. CO. ACCT. OVERSIGHT BD., *supra* note 10.

[227] *Fact Sheet: China Agreement*, PUB. CO. ACCT. OVERSIGHT BD. (Aug. 26, 2022), https://pcaobus.org/news-events/news-releases/news-release-detail/fact-sheet-china-agreement [https://perma.cc/6LM3-RUSQ].

[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[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.[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.[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.[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.[235]Delistings may threaten a lucrative source of capital for the U.S. investment banks,[236] but this is unlikely to be persuasive in bringing about a less strict approach to enforcement of the HFCAA.[237] It is therefore important that China has relaxed its approach, and consequently averted the threat of large-scale delistings.[238] Moreover, any firms that remain under

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[231] Foley, *supra* note 65.

[232] Lydia Beyoud et al., *Chinese Stock Delisting Threat Eases as US Gets Access to Audit Data*, BLOOMBERG (Dec. 15, 2022, 7:49 PM), https://www.bloomberg.com/news/articles/2022-12-15/chinese-stock-delisting-risk-falls-after-us-watchdog-got-access [https://perma.cc/G9ED-BD7N].

[233] *See* Foley, *supra* note 65.

[234] Beyoud et al., *supra* note 232.

[235] 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.

[236] 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].

[237] Henderson & Lockett, *supra* note 215.

[238] Yang et al., *supra* note 225.

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.[239] 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.[240] The disclosure rules require issuers to distinguish between shell companies and the operating companies in China, including the enforceability of certain contractual arrangements.[241] Thus, investors would have information regarding the VIE contractual arrangements, which, as noted, can be misleading for investors.[242] The firms should also disclose whether Chinese law allows them to list in the United States via an offshore shell company.[243] 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.[244] 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.[245]

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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[239] Holding Foreign Companies Accountable Act Disclosure Release No. 34-91364, 86 Fed. Reg. 70,027, 70,040 (Apr. 5, 2021).

[240] *Id.*

[241] *Id.*

[242] *Id.*

[243] Hopkins et al., *supra* note 109.

[244] Complaint at 10–11, *In Re Didi Global Inc., Sec. Litig.* No. 1:2021cv 05807 (S.D.N.Y July 6, 2021).

[245] Gary Gensler, *Statement on Investor Protection Related to Recent Developments in China*, SEC (July 30, 2021), https://www.sec.gov/news/public-statement/gensler-2021-07-30 [https://perma.cc/B8GR-RA4U].

Western-style transparency far more complicated.[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.[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[248]—and identifies risks, including the prospect of Chinese governmental intervention.[249]

3. Foreign Government Ownership or Control

The HFCAA also requires the disclosure of information regarding ownership or control by foreign governments.[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.[251] There may be doubts, however, as to whether these elements alone or cumulatively can combine to establish government control.[252]

"Golden shares"[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.[254] A state agency will typically hold a one percent or other small-sized investment, which can bring the power to appoint a director.[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

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[246] Sommer, *supra* note 117.

[247] Gensler, *supra* note 245.

[248] Holding Foreign Companies Accountable Act Disclosure Release No. 34-91364, 86 Fed. Reg. 70,027, 70,029 (Apr. 5, 2021).

[249] *Sample Letter to China-Based Companies*, SEC (Dec. 20, 2021), https://www.sec.gov/corpfin/sample-letter-china-based-companies [https://perma.cc/UK7L-3SZP].

[250] 15 U.S.C. § 7214(i)(2)(B).

[251] Yingzhi Yang et al., *Fretting About Data Security, China's Government Expands Its Use of 'Golden Shares'*, REUTERS (Dec. 16, 2021, 7:00 AM), https://www.reuters.com/markets/deals/exclusive-fretting-about-data-security-chinas-government-expands-its-use-golden-2021-12-15/ [https://perma.cc/S7TN-XVBJ].

[252] *See id.*

[253] Bernardo Bortolotti & Mara Faccio, *Government Control of Privatized Firms*, 22 REV. FIN. STUDS. 2907, 2939 (2009).

[254] Yang et al., *supra* note 251.

[255] Pearson et al., *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.[256] These shares enable state agencies to monitor the collection, storage, and usage of customer data by these firms[257] 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.[258] 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.[259] By themselves, golden shares would therefore not seem to create government control for the purposes of the HFCAA.[260]

Another relevant factor in assessing foreign government ownership or control may be the CCP's party cells.[261] 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,[262] stoking external suspicions.[263] Huawei is given as an early example of strong party involvement in a firm through the establishment

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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.*

[258] *See* Angela Huyue Zhang, *State Influence Through Golden Shares*, TABLE CHINA (May 23, 2022), https://table.media/china/en/opinion/state-influence-through-golden-shares/ [https://perma.cc/L4HV-7AQW].

[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.*

[261] Party cells can be established if three or more CPC members working at the firm request it. [Companies Law of China] (promulgated by the Second Session of the Tenth National People's Congress on Oct. 27, 2005, effective Jan. 1, 2006), art. 19, 2006 P.R.C. LAWS (China), https://www.ilo.org/dyn/natlex/docs/ELECTRONIC/92643/108008/F-186401967/CHN92643%20Eng.pdf [https://perma.cc/7FDH-HJTB]; [Constitution of the Communist Party of China] arts. 30, 33 (2017), http://www.xinhuanet.com//English/download/Constitution_of_the_Communist_Party_of_China.pdf [https://perma.cc/4YMZ-63F7].

[262] Daniel Koss, *Party Building as Institutional Bricolage: Asserting Authority at the Business Frontier*, 248 CHINA Q. 222, 229–30 (2021).

[263] Xiaojun Yan & Jie Huang, *Navigating Unknown Waters: The Chinese Communist Party's New Presence in the Private Sector*, 17 CHINA REV. 37, 38 (2017).

of a party committee, but it also highlights that the relationship may not always be as onlookers expect.[264] Party members reportedly had difficulties in adjusting to "shrewd, successful and self-confident global entrepreneurs" who would not blindly follow directions.[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.[266] Huawei's party cell has also been identified as having involvement in mentoring and other personal development activities.[267] Other nonstate companies have found that party cells bring tax benefits, improve access to credit, and provide ways around regulatory limits.[268] It is also notable that personal links with the party have been mutually beneficial in terms of strong ties based on *guanxi*, which are important in Chinese business culture.[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.[270] An illustration is ByteDance's refusal to allow a TikTok account to be created for propaganda towards Western audiences.[271] Again, the presence of a party cell is arguably not sufficient in itself to establish Chinese government control.[272]

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[264] *See* Koss, *supra* note 262, at 227.

[265] *Id.*

[266] Colin Hawes, *Why is Huawei's Ownership so Strange? A Case Study of the Chinese Corporate and Socio-Political Ecosystem*, 21 J. CORP. L. STUDS. 1, 5 (2021).

[267] *Id.* at 19.

[268] *Id.* at 6.

[269] Christopher A. McNally & Teresa Wright, *Sources of Social Support for China's Current Political Order: The "Thick Embeddedness" of Private Capital Holders*, 43 COMMUNIST POST-COMMUNIST STUDS. 189, 190 (2010).

[270] Isabela Nogueira & Hao Qi, *The State and Domestic Capitalists in China's Economic Transition: from Great Compromise to Strained Alliance*, 51 CRITICAL ASIAN STUDS. 558, 661 (2019); Nana de Graaff, *China Inc. Goes Global. Transnational and National Networks of China's Globalizing Business Elite*, 27 REV. INT'L POLIT. ECON. 208, 209–10 (2020).

[271] Olivia Solon, *Chinese Government Asked TikTok for Stealth Propaganda Account*, BLOOMBERG (July 29, 2022, 5:00 AM), https://www.bloomberg.com/news/articles/2022-07-29/chinese-government-asked-tiktok-for-stealth-propaganda-account [https://perma.cc/L3NK-SB8P].

[272] *See* Koss, *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

[273] *See* Julie Zhu et al., *Majority Shareholders Vote in Favor of Delisting Didi from New York*, REUTERS (May 23, 2022, 12:14 PM), https://www.reuters.com/markets/europe/majority-shareholders-vote-favor-delisting-didi-new-york-2022-05-23/ [https://perma.cc/M3CE-V5VU].

[274] Ren-En Lim, *Reviewing Recent Developments in China's Capital Markets and Assessing the Relevance of the Proposed Shanghai International Board*, 12 CAP. MKTS. L.J. 78, 78–81 (2017).

[275] *Id.*

[276] *See* Samuel Shen & Xie Yu, *Analysis: China Investors Hedge U.S. Delisting Risk with Hong Kong Play*, REUTERS (Aug. 10, 2022, 3:53 PM), https://www.reuters.com/markets/us/china-investors-hedge-us-delisting-risk-with-hong-kong-play-2022-08-10/ [https://perma.cc/CL86-QR6T].

[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].

[279] *See* Coco Liu & John Cheng, *Alibaba Seeks Primary Hong Kong Listing as US Exit Looms*, BLOOMBERG (July 26, 2022, 9:33 AM), https://www.bloomberg.com/news/articles/2022-07-26/alibaba-to-apply-for-primary-stock-listing-in-hong-kong [https://perma.cc/JX73-X6X4].

Alibaba, JD.com and NetEase, have already begun protecting their interests with secondary listings on the HKEX.[280]

There have been aspects of a regulatory race in the ascent of the HKEX and its approach to dual class shares.[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.[282]

The HKEX's approach to dual-class shares previously could have deterred migrations from the United States following the HFCAA.[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.[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.[285] This change in attitude towards permission of the dual-class IPOs well epitomizes the regulatory

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[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].

[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).

[282] *Id.*

[283] Jennifer Hughes, *Hong Kong to Push Ahead with Controversial Dual-Class Shares*, REUTERS (Dec. 15, 2017, 4:34 AM), https://www.reuters.com/article/us-hkex-regulation/hong-kong-to-push-ahead-with-controversial-dual-class-shares-idUSKBN1E90UR [https://perma.cc/2ME4-DNNE].

[284] Noah Sin, Alun John, et al., *Hong Kong's Hang Seng Benchmark Paves Way to Include Alibaba*, REUTERS (May 18, 2020, 5:34 AM), https://www.reuters.com/article/us-china-hongkong-markets-alibaba-idUKKBN22U145 [https://perma.cc/58YD-2DMY].

[285] HKEX, *Consultation Conclusions: Listing Regime for Overseas Issuers*, ¶¶ 142–58 (Nov. 2021), https://www.hkex.com.hk/-/media/HKEX-Market/News/Market-Consultations/2016-Present/March-2021-Listing-Regime/Conclusions-(Nov-2021)/cp202103cc.pdf [https://perma.cc/5H7D-USJG].

race theory,[286] and the reform has paved the way for ULCCs to list in the HKEX.[287] In November 2019, Alibaba's secondary listing in the HKEX helped it secure nearly $13 billion in capital.[288] Alibaba's success has mainstreamed a growing trend of secondary listings by Chinese tech giants.[289] 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.[290]

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.[291] Nevertheless, Hong Kong's dwindling political freedoms may impact its appeal as a globalized financial center.[292] Erosion of the rule of law could lessen future foreign capital inflows, ultimately impacting Hong Kong's status as an international financial center.[293] This is especially true in terms of the delisting and relisting strategy exploited by many Cayman-incorporated companies.[294] After all, whether a regulatory race ensues depends on how China

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[286] Bobby Reddy, *Finding the British Google: Relaxing the Prohibition of Dual-Class Stock from the Premium-Tier of the London Stock Exchange*, 79 CAMBRIDGE L.J. 315, 348 (2020).

[287] *See* HKEX, *supra* note 285.

[288] Stu Woo, *Alibaba Shares Enjoy a Strong Start in Hong Kong*, WALL ST. J. (Nov. 26, 2019, 5:25 PM), https://www.wsj.com/articles/a-strong-open-sesame-for-alibaba-in-hong-kong-11574746859 [https://perma.cc/QX5K-CR55].

[289] Priyanka Boghani & Umer Khan, *Dual Hong Kong Listings Still Attractive to US-Listed Chinese TMT Companies*, S&P GLOB. (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 [https://perma.cc/TAE4-5LR4].

[290] Alex Frew McMillan, *JD.com, NetEase See Index Switch from New York To Hong Kong*, REAL MONEY (Nov. 22, 2022, 6:58 AM), https://realmoney.thestreet.com/investing/stocks/jd-com-netease-see-index-switch-from-new-york-to-hong-kong-15839994 [https://perma.cc/D46L-BGAK].

[291] FED. SERV. DEV. COUNCIL, *Hong Kong's Capital Market—From Homecoming IPOs to Capturing Future Tech Opportunities,* HK FSDC (Aug. 29, 2022), https://www.fsdc.org.hk/en/media/hong-kong-s-capital-market-from-homecoming-ipos-to-capturing-future-tech-opportunities [https://perma.cc/J2TB-8QLH].

[292] Calhoun, *supra* note 54.

[293] *Id.*

[294] Joe Liebkind, *Loophole Exploitation Aggravates Chinese and Foreign Regulators*, INT'L POL'Y DIG. (Sep. 26, 2019), https://intpolicydigest.org/loophole-exploitation-aggravates-chinese-and-foreign-regulators/ [https://perma.cc/GQ5T-H7X2].

responds and whether it alters its own policies with the aim of preventing movements of capital.[295]

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.[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.[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.[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.[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.[300]

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

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[295] Carruthers & Lamoreaux, *supra* note 281.

[296] Daniel Yeh et al., *The HFCAA and Consequences for US-Listed China-Based Companies*, WHITE & CASE (Aug. 5, 2022), https://www.whitecase.com/insight-our-thinking/hfcaa-and-consequences-us-listed-china-based-companies [https://perma.cc/MKT6-YXGD].

[297] *Id.*

[298] *Id.*

[299] *Id.*

[300] *See* Teri O'Brien et al., *Finding Your Way Through the Delisting and Deregistration Door—Steps for Acquired Public Companies to Terminate and Suspend Exchange Act Reporting Requirements*, PAUL HASTINGS (May 9, 2019), https://www.paulhastings.com/insights/client-alerts/find-your-way-through-the-delisting-and-deregistration-door-steps-for-acquired-public-companies-to-terminate-and-suspend-exchange-act-reporting-requirements [https://perma.cc/JH7B-XW2B].

outright decoupling and unconditional engagement.[301] 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.[302] Achievement of these ambitions is unlikely to be straightforward.[303]

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.[304] External controversy[305] contributed to the Made in China 2025 strategy being toned down in rhetoric.[306] However, it also led to Chinese ambitions regarding self-sufficiency in key industries, concerns which are particularly heightened in the case of semiconductors.[307]

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[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.

[304] *Made in China 2025*, CHINA GOV'T NETWORK, http://www.gov.cn/zhuanti/2016/MadeinChina2025-plan/index.htm [https://perma.cc/XS9E-RLG2].

[305] Memorandum on Addressing China's Laws, Pol'ys, Prac., and Actions Related to Intell. Prop., Innovation, and Tech., DCPD-201700572 (Aug. 14, 2017); Memorandum on *Actions by the U.S. Related to the Section 301 Investigation of China's Laws, Pol'ys, Prac., or Actions Related to Tech. Transfer, Intell. Prop., and Innovation*, DCPD-201800180 (Mar. 22, 2018); *see* Sun Haiyong, *U.S. China Tech War, Impacts and Prospects*, 5:2 CHINA Q. INT'L STRATEGIC STUDS. 197, 197–201 (2019).

[306] George Magnus, *The Rhetoric Is Changing but Xi Jinping Is Staying the Course*, FIN. TIMES (Jan. 6, 2019), https://www.ft.com/content/7c90ac22-101a-11e9-b2f2-f4c566a4fc5f [https://perma.cc/PP2K-QF2J].

[307] *See, e.g.*, Gordon Orr & Christopher Thomas, *Semiconductors in China: Brave New World or Same Old Story?*, MCKINSEY & CO. (Aug. 1, 2014), https://

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.[308] This sector is particularly sensitive,[309] with the contested Taiwan acting as the leading exporter, even more so after U.S. sanctions.[310] 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.[311] 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.[312] Importantly, non-U.S. companies are eligible for these grants, a carrot that could tempt South Korean manufacturers.[313] There is also an important stick of civil and criminal penalties for those who violate U.S. export controls,[314] a threat magnified by its broad and underdefined

www.mckinsey.com/industries/semiconductors/our-insights/semiconductors-in-china-brave-new-world-or-same-old-story [https://perma.cc/AAS5-BT4S].

[308] *Id.* China is the largest consumer of semiconductors with an estimated forty-five percent of the global supply in 2017, around ninety percent of which are imported. *Id.*

[309] Yuan Yang & Nian Liu, *China's Biggest Chipmaker Bets on Shanghai Listing*, FIN. TIMES (June 15, 2020), https://www.ft.com/content/b60d7c99-1da1-452d-9396-68c5fa136fe1 [https://perma.cc/6KDB-5ARH].

[310] Anna Swanson & Raymond Zhong, *U.S. Places Restrictions on China's Leading Chip Maker*, N.Y. TIMES (July 19, 2021), https://www.nytimes.com/2020/09/26/technology/trump-china-smic-blacklist.html [https://perma.cc/FZH4-S3N2].

[311] Addition of Entities to the Entity List, Revision of Entry on the Entity List, and Removal of Entities From the Entity List, 15 C.F.R. pt. 744 (2020).

[312] Catherine Pan-Giordano & Ting Zhou, *The CHIPS and Sciences ACT of 2022—The Impact on China*, DORSEY & WHITNEY LLP (Sep. 19, 2022), https://www.dorsey.com/newsresources/publications/client-alerts/2022/09/the-chips-and-sciences-act-of-2022 [https://perma.cc/A8QS-5G3F].

[313] *Id.*

[314] Industry and Security Bureau, Implementation of Additional Export Controls: Certain Advanced Computing and Semiconductor Manufacturing Items; Supercomputer and Semiconductor End Use; Entity List Modification,

scope.[315] 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.[316]

China has plans for not just self-reliance but also dominance in key high-end areas of technology[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."[318] Successive initiatives have aimed to propel China from the third tier to the first tier.[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.[320] There are also ambitions to pioneer a new general-purpose technology, based on data, communication, and artificial intelligence.[321]

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87 Fed. Reg. 62,195, 62,195 (Oct. 07, 2022); Ravi Agrawal, A*merica's Risky New China Policy*, FOREIGN AFFS. (Nov. 2, 2022, 11:12 AM), https://foreignpolicy.com/2022/11/02/united-states-china-semiconductor-imports/ [https://perma.cc/2RT8-HD7G].

[315] Stefan H. Reisinger, *New Export Controls on Semiconductor and Advanced Computing Related Items to China*, NORTON ROSE FULBRIGHT (Oct. 2022), https://www.nortonrosefulbright.com/en/knowledge/publications/f3f0dd98/new-export-controls-on-semiconductor-and-advanced-computing-related-items-to-china [https://perma.cc/64BN-998R].

[316] *See* Agrawal, *supra* note 314.

[317] *See* Dan Wang, *China's Sputnik Moment,* FOREIGN AFFS. (July 29, 2021), https://www.foreignaffairs.com/articles/united-states/2021-07-29/chinas-sputnik-moment [https://perma.cc/6KDW-62ZL].

[318] Alexander Chipman Koty, *What is the China Standards 2035 Plan and How Will it Impact Emerging Industries?*, CHINA BRIEFING (July 2, 2020), https://www.china-briefing.com/news/what-is-china-standards-2035-plan-how-will-it-impact-emerging-technologies-what-is-link-made-in-china-2025-goals/ [https://perma.cc/25T5-R2BH].

[319] *Id.*

[320] Arjun Gargeyas, *China's 'Standards 2035' Project Could Result in a Technological Cold War*, THE DIPLOMAT (Sep. 18, 2021), https://thediplomat.com/2021/09/chinas-standards-2035-project-could-result-in-a-technological-cold-war/ [https://perma.cc/5CR4-GZKN].

[321] Barry Naughton, *Six Factors behind China's Shift to "Grand Steerage*", CHINESE ST. CAPITALISM DIAGNOSIS AND PROGNOSIS 3, 7–8 (2021).

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 SMIC[325] 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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[322] Grady McGregor, *Didi's New York delisting signals an end to Chinese firms' glory days on U.S. exchanges*, FORTUNE (Dec. 3, 2021, 4:00 AM), https://fortune.com/2021/12/03/didi-delisting-stock-share-price-new-york-hong-kong-china/ [https://perma.cc/3X5F-7W42].

[323] *Id.*

[324] Raymond Zhong & Peter Eavis, *Didi's Regulatory Troubles Might Just Be Getting Started*, N.Y. TIMES (Aug. 27, 2021), https://www.nytimes.com/2021/07/07/business/china-didi-crackdown.html [https://perma.cc/FHR6-R6GK].

[325] Yang & Liu, *supra* note 309.

[326] Lulu Yilun Chen & John Cheng, *China State-Owned Giants to Delist From US Amid Audit Spat,* BLOOMBERG (Aug. 12, 2022, 10:15 AM), https://www.bloomberg.com/news/articles/2022-08-12/china-state-owned-giants-plan-to-delist-from-us-amid-audit-spat [https://perma.cc/9MQW-DKX2].

[327] Jeffrey J. Schott et al., *Investment from China into the United States Has Fallen to Nearly Zero*, PETERSON INST. INT'L ECON. (May 21, 2019), https://www.piie.com/research/piie-charts/investment-china-united-states-has-fallen-nearly-zero [https://perma.cc/EX5N-T26D].

[328] *Id.*

[329] *Intent on Decoupling*, *supra* note 181.

audit inspection requirements.[330] Yet, a remaining problem for the CCP is that economic growth has long been key for the CCP's legitimacy,[331] but it has been damaged by the pursuit of other policy objectives that have led to the value of some ULCCs being pummeled.[332] 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.[333] 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,[334] and it is imperative that alternative growth drivers are in place.[335]

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

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[330] *See* Christopher Davies, *Three Reasons the PCAOB's Agreement With China May Not Have Changed the Landscape*, WILMERHALE (Aug. 30, 2022), https://www.wilmerhale.com/en/insights/client-alerts/20220830-three-reasons-the-pcaobs-agreement-with-china-may-not-have-changed-the-landscape [https://perma.cc/567S-PEE6].

[331] David O. Shullman, *Protect the Party: China's Growing Influence in the Developing World*, BROOKINGS (Jan. 22, 2019), https://www.brookings.edu/articles/protect-the-party-chinas-growing-influence-in-the-developing-world/ [https://perma.cc/22Q7-X52G].

[332] Jeff Sommer, *Invest in China, but Without Illusions*, N.Y. TIMES (July 23, 2021), https://www.nytimes.com/2021/07/23/business/china-stock-market-invest.html [https://perma.cc/4PJM-3LZF].

[333] Horta e Costa, *supra* note 49.

[334] Adam Lysenko et al., *US-China Financial Investment: Current Scope and Future Potential*, RHODIUM GRP. (Jan. 25, 2021), https://rhg.com/wp-content/uploads/2021/01/US-China-Financial-Investment_25Jan2021-2.pdf [https://perma.cc/T64D-KPVR].

[335] Stephanie K. Pell & Bill Baer, *Protecting National Security, Cybersecurity, and Privacy while Ensuring Competition*, BROOKINGS (Jan. 19, 2022), https://www.brookings.edu/blog/techtank/2022/01/19/protecting-national-security-cybersecurity-and-privacy-while-ensuring-competition/ [https://perma.cc/3JNP-TV3M].

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 nonstate 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.