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China's One Country, Two Systems Paradigm Extends Itself Beyond the Mainland's Borders to the Southern Provincial Government of Hong Kong

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Cover Page Footnote

Law Clerk to Justice Bernard J. Fried of the Supreme Court of the State of New York. Graduated from Brooklyn Law School in June 2001, and from the Bernard M. Baruch College/City University of New York Master of Business Administration Program in February 1997. Previously employed as a trading investigator in the Market Surveillance Division of the New York Stock Exchange and as a special sales consultant in the Corporate Executive Services Group of the Investment Bank at Prudential Securities. This article was the product of my diligent work in Professor (and former Commissioner of the United States Securities and Exchange Commission) Roberta Karmel's seminar on International Securities Regulation at Brooklyn Law School. My interest in the subject of Chinese and Hong Kong securities law was inspired by my participation in the Brooklyn Law School/Loyola Law School study abroad program at the University of International Business And Economics in Beijing, China.

CHINA'S ONE COUNTRY, TWO SYSTEMS PARADIGM EXTENDS ITSELF BEYOND THE MAINLAND'S BORDERS TO THE SOUTHERN PROVINCIAL GOVERNMENT OF HONG KONG

WILLIAM I. FRIEDMAN*

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I. INTRODUCTION

Since 1978, when China's Premier Minister, Deng Xiaoping, adopted the nation's "open door" policy,¹ China has gradually

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1. Todd Kenneth Ramey, *China: Socialism Embraces Capitalism? An Oxymoron for the Turn of the Century: A Study of the Restructuring of the Securities Markets and Banking Industry in the People's Republic of China in an Effort to Increase Investment Capital*, 20 HOUS. J. INT'L L. 451, 456 (1998) (stating that Deng Xiaoping's "open door" policy centered on economic reforms utilizing market mechanisms and foreign resource to speed up the growth and modernization of the Chinese economy).

moved away from its Marxist past toward a more Capitalist driven market structure. In July 1999, China's National People's Congress ("NPC") even went so far as to enact its first comprehensive national Securities Law to support the nation's economic reforms.² Since then, however, China has struggled to establish a credible and reliable Securities Law to contravene the corrupt practices of its Communist government, which has been in power since the country's 1949 Revolution. The weaknesses of China's legal system are attributable to the inherent conflict between the nation's Communist government and Capitalist market structure, which has worked to undermine the impact of China's written laws. Hence, the worthlessness of China's written laws, combined with "the many rigidities of [its] economy and political barriers,"³ has made the international community fearful of investing its capital in China's red chip companies.⁴

In sharp contrast to the problems associated with China's legal system is the southern provincial government of Hong Kong, which has in place, as established under British colonial rule, a "credible and reliable legal system to underpin its economy."⁵ The strength of Hong Kong's legal system is the main ingredient to the success of its market economy, as without it, the market economy is but a "jungle economy," which is not a place where reasonable persons would knowingly invest their life savings.⁶ Hong Kong's legal system consists of the law-making parliament, an uncorrupted police that enforces the laws, and independent courts and judges that interpret the laws and resolve legal disputes.⁷ More importantly, the laws in Hong Kong "appl[y] equally to those who govern and those who are governed," thereby creating an environment where nobody is above the law, from the President to those of a citizen or corporation.⁸ Furthermore, Hong Kong's laws

2. SECURITIES LAW OF CHINA (China enacted its first comprehensive national Securities Law on December 29, 1998, which subsequently went into effect on July 1, 1999); see also COMPANY LAW OF CHINA (China's Company Law was adopted by the 5th Session of the Standing Committee of the 8th National People's Congress, promulgated on December 29, 1993 and effective as of July 1, 1994, to standardize the organization and activities of P.R.C. companies.).

3. THE HONG KONG READER: PASSAGE TO CHINESE SOVEREIGNTY 201 (Ming K. Chan and Gerard A. Postiglione eds., 1996) [hereinafter HONG KONG READER].

4. China's "red chip" companies signifies its nation's premier large-capitalization companies. They are synonymous with the "blue chip" companies listed on the Dow Jones in the United States.

5. *How Hong Kong Can Change China*, THE ECONOMIST, June 28, 1997, at 15.

6. CHRISTOPHER PATTEN, EAST AND WEST: CHINA, POWER AND THE FUTURE OF ASIA 230 (1998).

7. *Id.*

8. *Id.* at 229.

are clear, predictable, and easily understandable, and therefore not arbitrary, capricious or uncertain, like in China.⁹ Moreover, the laws offer transparency and openness in the market, through the guarantee of such democratic values as freedom of speech and press, and the mandatory disclosure requirements in the marketplace.¹⁰ In sum, Hong Kong's "rule of law"¹¹ has

9. *Id.* at 230, 235.

10. *Id.* at 231, 234.

11. HONG KONG DEPT OF JUSTICE, *The Legal System in Hong Kong: The Rule of Law*, at <http://www.info.gov.hk/justice/new/legal/index.htm> (last visited Feb. 13, 2002).

The 'Rule of Law' refers to some of the fundamental principles of law that govern the way in which power is exercised in Hong Kong. The Rule of Law has several different meanings and corollaries. Its principal meaning is that the power of the Government and all of its servants shall be derived from law as expressed in legislation and the judicial decisions made by independent courts. At the heart of Hong Kong's system of government lies the principle that no one, including the Chief Executive, can do an act which would otherwise constitute a legal wrong or affect a person's liberty unless he can point to a legal justification for that action. If he cannot do so, the affected person can resort to a court which may rule that the act is invalid and of no legal effect. Compensation may be ordered in the affected person's favour. This aspect of the Rule of Law is referred to as the principle of legality.

One corollary of the principle of legality can be summarised as equality before the law. It is fundamental that all persons, regardless of race, rank, politics or religion, are subject to the laws of the land. Further, the Rule of Law requires that the courts are independent of the Executive. This independence is crucial if impartial rulings are to be given when the legality of acts of government falls to be decided.

Legality and equality before the law are two fundamental facets of the 'Rule of Law'. But the principle demands something more, otherwise it would be satisfied by giving the Government unrestricted discretionary powers. A further meaning of the Rule of Law, therefore, is to be found in a system of rules which restrict discretionary power. To this end the courts have developed a set of guidelines aimed at ensuring that statutory powers are not used in ways which the Legislature did not intend. These guidelines relate to both the substance and the procedures relating to the exercise of executive power. An example of the former is where a court concludes that a decision which purports to be authorised by a statutory power is plainly unreasonable and cannot have been envisaged by the Legislature. An example of the latter is where a decision has been made without according the party affected the opportunity of being heard in circumstances where the Legislature must have envisaged that such an opportunity would have been given. In both cases a court would hold that the decisions were legally invalid.

Id.; see also Jacques deLisle & Kevin P. Lane, *Hong Kong's Endgame and the Rule of Law (II): The Battle over "The People" and the Business Community in the Transition to Chinese Rule*, 18 U. PA. J. INT'L ECON. L. 811, 831-34 (1997).

Indeed, the Hong Kong people regarded the rule of law as one of the truly definitive traits of Hong Kong that 'distinguished Hong Kong from all other Asian societies.' In his final annual policy address, Governor Patten asserted that the 'peace and safety guaranteed by the rule of

transformed this once "barren" island into a safe haven for the world's investments, as the "rule of law" is the underpinning of the territory's lucrative and stable market economy, and enjoys an esteemed status as an international financial center.

Consequently, many of Mainland China's red chip companies and the world's blue chip companies have set up shop in Hong Kong instead of Shanghai.¹² Hong Kong, which has developed into a gateway to the vast economic hinterland of China, has taken on the role of a forum for channeling foreign investment into Mainland China's enterprises, as well as a forum for Mainland China to engage in securities trading with the international community. Thus, the efficiency of Hong Kong as a "middleman" has proven crucial to China's economic interactions with the world,¹³ as it will aid the Beijing government through the torturous and difficult process of implementing its economic reforms. As an indirect result of this relationship, however, the two territories' economies will gradually become more integrated. Thereafter, the Beijing government will learn that it may no longer reap the benefits of its economic relationship with Hong Kong without a political agenda arising. Consequently, any attempt by the Beijing government to separate economics and politics in order to maintain its "one country, two systems" paradigm,¹⁴ will fail.¹⁵ Thus, China's Communist Party has

law' had prompted much of Hong Kong's population to flee to the territory from China.

Id. at 831-32 (citations omitted). Another government official, Democratic Party leader and Legislative Councillor Martin Lee, also noted that:

'In Hong Kong, when we think about the rule of law, key principles come to mind: clear rules that citizens can follow; a judiciary free from political influence; the right to sue the Government; . . . and a court system that will allow justice to be done . . . ' The Hong Kong Bar Association made a similar point in a letter to the Chief Executive-designate: The rule of law does not merely mean that there is a body of law by which the people will be ruled. . . . The rule of law also means the process of making and repealing law is open, reasoned and in accordance with the law. If not, . . . it will become rule by the people in power.

Id. at 833-34 (alteration in original) (citations omitted).

12. *The Wild West of the East*, THE ECONOMIST (July 10, 1997), at <http://www.economist.com>. One political-risk consultancy termed the "rush for a Hong Kong listing as a 'coming-out party' for Chinese companies Hong Kong's recent success also dispels the oft-touted notion that Shanghai, before long, will displace Hong Kong as China's centre for international capital." *Id.* See also Nathan N. McMurray, *Enforcing Voluntary Compliance: The Need to Strengthen Hong Kong's Merger and Acquisition Regulations*, 12 COLUM. J. ASIAN L. 75, 80 (1998).

13. HONG KONG READER, *supra* note 3, at 206.

14. Sheba Mary Vattamattam, *Preserving Hong Kong's Autonomy While Facilitating Chinese Reform: The Potential Role of Globalization in Guiding China's Governance*, 7 IND. J. GLOBAL LEGAL STUDIES 713, 713 (2000). The Sino-British Joint Declaration "promised

subconsciously put into motion a process of modernity that will revolutionize its economy as well as the politics of its government. This process will eventually result in the fall of the old Chinese Communist Guard by giving rise to a new era in Chinese history that is founded on the "rule of law," market economics and democratic values.

However, it is feasible although highly unlikely that the Beijing government would choose to suffocate Hong Kong's economy for its own short-term financial gains in order to further its nationalistic policy objectives of having Shanghai replace Hong Kong as the country's primary financial center. This is a foreseeable result since the British government, prior to its hand-over of Hong Kong to China, had failed to replace its colonial government in Hong Kong with a democratically driven institution of government.¹⁶ Thus, Hong Kong's securities laws are all susceptible to the discretionary authority of its territory's Governor, Tung Chee-hwa,¹⁷ and Provisional Legislature, political

an uneventful reunion between Hong Kong and China, in 'guaranteeing' a one-country, two systems paradigm [which] preserve[s] Hong Kong's capitalist economy, democracy, rule of law, and other forms of liberal constitutional governance," while simultaneously maintaining China's ruling Communist Party's Marxist ideology for the citizens of Mainland China. *Id.* See generally Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, Apr. 4, 1988, 29 I.L.M. 1511 (*ratified* Mar. 1990; *adopted* by the 7th National People's Congress at its Third Session, Apr. 1990), 1990 Fagui Huibian [hereinafter Basic Law]. "[U]nder the principle of 'one country, two systems', the socialist system and policies [of China] will not be practised in Hong Kong." *Id.* pmb., 29 I.L.M. at 1520. See also Sean Cooney, *Why Taiwan is Not Hong Kong: A Review of the PRC's "One Country, Two Systems" Model for Reunification with Taiwan*, 6 PAC. RIM. L. & POLY 497, 505 (1997) ("The concrete form of one country, two systems as it applies to Hong Kong is now reflected in the Basic Law of Hong Kong Special Administrative Region.").

15. See PATTEN, *supra* note 6, at 229.

16. Basic Law, *supra* note 14. The Sino-British 1984 Joint Declaration led to the promulgation of a Basic Law for the Hong Kong Special Administrative Region ("SAR"), which was adopted on April 4, 1990 by the Seventh National People's Congress of the People's Republic of China at its Third Session. THE HONG KONG BASIC LAW: BLUEPRINT FOR "STABILITY AND PROSPERITY" UNDER CHINESE SOVEREIGNTY 165-209 (Ming K. Chan & David J. Clark eds., 1991). Its primary purpose was to retain the presently democratically driven rule of law in Hong Kong for the first 50 years following the territory's reunification with China. The Basic Law, however, failed to establish a definitive democratic government, which would succeed the year 2047, the date at which the Basic Law is to expire, and the NPC will have the opportunity to transform the territory's capitalist system and way of life into a socialist system, similar to the one practiced in China. *Id.*

17. Based on the inefficiencies of Hong Kong's securities law, the Governor possesses the capacity to manipulate the Securities and Futures Commission's regulatory responsibilities due to his statutorily defined powers, which enable him to unilaterally appoint, remove, reward and punish members of the Commission and its advisory committees, and direct the Commission's performance of its regulatory functions. See Securities and Futures Commission Ordinance (Cap. 24) (H.K. 1989), *reprinted* in Cally Jordan & Colleen Stanley, *Hong Kong*, INTERNATIONAL SECURITIES REGULATION 1-60 (Robert C. Rosen ed., 2001) [hereinafter Securities and Futures Commission Ordinance]. "The Commission shall consist of a chairman appointed by the Governor and . . . other

appointees of the Beijing government.¹⁸ Consequentially, the activities of Hong Kong's government and market officials are attributable to the political whims of Governor Tung Chee-hwa. Additionally, Hong Kong's Basic Law is allocated to China's NPC supreme decision-making authority with respect to its interpretation of the Law¹⁹ as well as the determination of the territory's fiscal operations,²⁰ thus placing Hong Kong at the impulse of the Beijing government's nationalistic initiatives.

It is highly unlikely, however, that the Beijing government would ever dare to act in a manner that would impede with Hong Kong's status as an international finance center, since such an act would close the gates of China's doorway to the world's capital. This outcome would be entirely unacceptable in the eyes of the Beijing government, since it is dependent upon the venues of Hong Kong to raise capital from the international community to salvage its ailing state-run economy from dissolution and insolvency and to push forward with its economic reforms.²¹ Moreover, China needs to demonstrate to the world that its

directors so appointed as the Governor may determine; . . ." *Id.* § 5(1). "The Governor may appoint an executive director to be deputy chairman of the Commission." *Id.* § 5(3). "The terms and conditions of office of a director of the Commission shall be such as the Governor may determine." *Id.* § 5(5). "A director of the Commission shall be paid by the Commission such remuneration, allowances or expenses as the Governor may determine." *Id.* § 5(7). "The Governor may by notice in writing remove from office any director of the Commission whose removal appears to him to be desirable for the effective performance by the Commission of its functions." *Id.* § 5(8). "The Governor may by notice in writing remove a person from membership of the Advisory Committee", whose purpose is to provide independent advice to the Commission. *Id.* § 10(7). "The Governor may give to the Commission such directions in writing as regards the performance of any of its functions as he considers appropriate." *Id.* § 11(1).

18. Michael C. Davis, *Constitutionalism Under Chinese Rule: Hong Kong after the Handover*, 27 DENV. J. INT'L L. & POL'Y 275, 298 (1999).

19. Basic Law, *supra* note 14, art. 107, 29 I.L.M. at 1537 (Essentially, China's NPC maintained a heavy hand in the territory's fiscal operations by explicitly providing that "[t]he Hong Kong Special Administrative Region shall follow the principle of keeping expenditure within the limits of revenues in drawing up its budget, and strive to achieve a fiscal balance, avoid deficits and keep the budget commensurate with the growth rate of its gross domestic product.").

20. *Id.* art. 158, 29 I.L.M. at 1545.

21. Lan Cao, *Chinese Privatization: Between Plan and Market*, LAW & CONTEMP. PROBS. 13, 43 (Autumn 2000).

Two overriding reasons [which] motivated China to convert its state enterprises into shareholding companies and to establish a securities market: first, the chronic inability of state firms to maintain financial self-sufficiency and solvency; and second, the desire of the state to tap into a growing pool of private capital in the non-state sector wholly outside of its control. By establishing a shareholding system, the government can alleviate the problem of state-sector insolvency, while bringing the increasingly threatening reservoir of private capital within the perimeters of the government-controlled state sector.

philosophy of a "one country, two systems" paradigm is a success in order to be able to one-day fashion a similar plan of reunification with neighboring Taiwan, as it ambitiously endeavors to establish a "One China."²² Thus, the Beijing government's policy of a "one country, two systems" paradigm must succeed, even if this governmental policy will consequentially serve to undermine the reign of the old Communist Guard in China.

Part II of this Note discusses the history of Hong Kong as it takes the reader back to the early part of the nineteenth century when the Chinese island of Hong Kong – a deserted and impoverished territory – was captured by the British. This section also gives an in depth explanation of the 1984 Sino-British Joint Declaration, which led to the promulgation of the Basic Law,²³ and the ultimate reunion between the People's Republic of China and Hong Kong on July 1, 1997. Moreover, this section explores the concerns of the international community and the questions that still lie ahead with respect to the reunification of China and Hong Kong.

Part III discusses Hong Kong's two-tier regulatory approach toward the territory's securities market – the Securities and Futures Commission and the Hong Kong Stock Exchange. This section also discusses how both legal institutions are held accountable to the discretionary authority of Hong Kong's Governor, Tung Chee-hwa.

Part IV discusses Hong Kong's Code on takeovers and mergers and its lack of legal force. This section also explores the role of the Beijing government in Hong Kong's takeover and merger process. Furthermore, this section reviews the impact of Mainland China's companies' employment of less stringent

22. Cooney, *supra* note 14, at 506 ("[China's] officials . . . have stated that the creation of the Hong Kong SAR will enable it to prove to Taiwan that [one country, two systems] is feasible and can operate successfully in Taiwan."). Deng Xiaoping stated, in a speech at the Third Conference of the Central Advisory Committee of the Chinese Communist Party on January 1, 1985 that "[t]he resolution of the Hong Kong question will directly influence the Taiwan question. Using the method of one country, two systems should be something they can accept." *Id.* at n.40. Then, a few years later, in 1988, Xiaoping stated in a speech to the Hong Kong SAR's Basic Law Drafting Committee that Hong Kong's "Basic Law . . . should set an example for . . . Taiwan, . . ." *Id.* (citing *Current Policies and Prospects for Hong Kong*, BEIJING REV., Jan. 4-10, 1988, at 14). Moreover, "[o]n Jan. 3, 1997, the official China News Agency's domestic service stated that the success of [one country, two systems] in Hong Kong 'will increase people's confidence and accumulate experiences that China can follow upon . . . settling the Taiwan issue.'" *Id.* (citing *Xinhua Looks Forward to Hong Kong's Future in 1997*, BBC SUMMARY OF WORLD BROADCASTS, Jan. 3, 1997, available in LEXIS, Asiapc Library, ALLNWS File).

23. Basic Law, *supra* note 14, pmbl., 29 I.L.M. at 1520.

accounting standards on Hong Kong's takeover and merger process. Moreover, this section looks at the impact of the corruption that is often instilled in Mainland China's companies upon Hong Kong's takeover and merger process.

Part V comments on an incident in which Hong Kong's Governor, Tung Chee-hwa, chose to exploit a strategy of government intervention, instead of *laissez-faire* economics, in his dealings with market speculation on the Hong Kong Stock Exchange. This section also comments on the consequences of this policy shift, which gave rise to a whole array of insider trading concerns in Hong Kong's stock market. Additionally, this section deals with the Hong Kong government's subsequent decision to retract from its initial position, which was pro-government intervention, in favor of a policy of *laissez-faire* economics.

Part VI elaborates on the dangers of corruption in a market economy and the crucial role that Hong Kong's Independent Commission Against Corruption ("ICAC") will play in preserving the integrity of the territory's marketplace after its passage to Chinese sovereignty. This section also comments on Hong Kong's Governor Tung Chee-hwa's discretionary authority over the ICAC.

Part VII tackles the issue of a media free Hong Kong, as guaranteed under Hong Kong's Basic Law. This section also looks at the potential threat posed to the future of Hong Kong's freedom of speech and press by the Beijing government following the territory's passage to Chinese sovereignty.

Part VIII discusses the Hong Kong law that requires shareholders to disclose their substantial interests in publicly held companies. This section also discusses the requirement that every public company publish a prospectus when doing a share offering, as well as the obligation of a public company to disclose information to the market on a continuous basis.

Part IX explores Hong Kong securities laws, which explicitly make it unlawful for a *tipper* or *tippee* to be involved in a transaction that involves the insider dealing of a listed security of a corporation. This section will also comment on the threat of insider dealing that has been posed by the Beijing government since Hong Kong's passage to Chinese sovereignty, and the exacerbation of this threat by Hong Kong's failure to criminalize insider dealing in its market. Part X discusses the benefits of private litigation in a nation's stock market. This section also explores the express private right of action by shareholders in the Hong Kong stock market, which is in direct contravention with China's marketplace. And finally, part XI discusses Hong Kong's

judiciary branch and the question of its independence from the influences of the Beijing government.

II. HISTORICAL BACKGROUND

In 1839, China, who was suspicious of "barbarians," insisted that trade with the outside world be conducted through Canton (modern-day Guangzhou) on its own national terms, contrary to Britain's policy, which advocated the free trade of opium.²⁴ This disagreement led to the fighting of the Opium War between 1839 and 1842.²⁵ At the conclusion of the War, China's forces were humbled as Britain's military seized control over the island of Hong Kong.²⁶ When hearing about the capture of Hong Kong, Britain's Foreign Secretary, Lord Palmerston, was infuriated at Captain Charles Elliot over his seizure of this "barren island, with hardly a house on it."²⁷ At the time, Hong Kong was predominantly a fishing village with a substandard economy, and so was considered the least important of the islands situated in the Pearl River.²⁸ On August 29, 1842, the Chinese formally ceded control of Hong Kong to Great Britain in the signing of the Treaty of Nanking.²⁹ On April 5, 1843, the Charter of Hong Kong was enacted under Letters Patent of Queen Victoria, which were to cease to operate in Hong Kong on July 1, 1997.³⁰ Further incursions between the British and Chinese at the end of the nineteenth century led to the cessation of new territories that formed the northern portion of modern-day Hong Kong.³¹

From 1842 to 1997, the British transformed Hong Kong from a "barren island" into one of the great economic powers in the world. Today, Hong Kong is a financial powerhouse, as it has "one of the four largest securities markets in the world."³² Its securities market and stock exchange is the eighth largest trading market in

24. *1898 and all that - A Brief History of Hong Kong*, THE ECONOMIST, June 26, 1997, at 22, available at http://www.economist.com/displayStory.cfm?Story_ID91779 [hereinafter *1898 and all that*].

25. *Id.*

26. *Id.*

27. *Id.*

28. Ted Hagelin, *Reflections on the Economic Future of Hong Kong*, 30 VAND. J. TRANSNAT'L. L. 701, 705 (1997).

29. Berry Fong-Chung Hsu, *Legislative Control of Hong Kong Financial Markets: Some Aspects of Banking and Securities Regulations*, 28 LAW & POL'Y INT'L BUS. 649, 651 (1997).

30. *Id.*

31. *1898 and all that*, *supra* note 24. See also Fong-Chung Hsu, *supra* note 29, at 651.

32. Lawrence L.C. Lee, *Integration of International Financial Regulatory Standards for the Chinese Economic Area: The Challenge for China, Hong Kong, and Taiwan*, 20 NW. J. INT'L L. & BUS. 1, 40 (1999).

the world, second only to the Tokyo Stock Exchange in the Asian region.³³ “[F]our thousand years of Chinese history had produced nothing like [modern-day] Hong Kong, a city where the ‘rule of law’ provided that security and majestic neutrality within which bank balances, ideas, and values could all flourish.”³⁴

In 1984, Britain and China signed a Joint Declaration, in which the two countries agreed that the island of Hong Kong would revert back to Chinese sovereignty on July 1, 1997 as a Special Administrative Region (“SAR”) of the People’s Republic of China.³⁵ Under the guidance of this Joint Declaration, the NPC enacted Hong Kong’s Basic Law on April 4, 1990, thus guaranteeing the existence of a “one country, two systems” paradigm between Hong Kong and China.³⁶ Hence, the Basic Law preserved Hong Kong’s autonomous nature as a territory.³⁷ It also stipulated that the “rule of law” in Hong Kong would remain unchanged for 50 years after the passage of Hong Kong to Chinese sovereignty, unless amended by the legislature of the Hong Kong SAR.³⁸ The Basic Law further guaranteed the preservation of Hong Kong’s capitalist system and way of life by explicitly prohibiting the institution of a “socialist system” for 50 years after Hong Kong’s reunification with China.³⁹ Moreover, Article 110 maintained the policy that Hong Kong’s monetary and financial systems would be governed by its “rule of law,” as opposed to China’s laws.⁴⁰ It also vested in the Hong Kong SAR Government independent authority over the formulation, regulation, and protection of monetary and financial policies and the territory’s financial business and markets.⁴¹ In essence, the Basic Law had the overall effect of promoting the message of “Hong Kong people ruling Hong Kong.”⁴²

33. *Id.* at 41.

34. PATTEN, *supra* note 6, at 153.

35. Fong-Chung Hsu, *supra* note 29, at 651.

36. *Id.* at 652.

37. Basic Law, *supra* note 14, arts. 2, 8 & 12, 29 I.L.M. at 1521-22.

38. Basic Law, *supra* note 14, art. 8, 29 I.L.M. at 1522; Fong-Chung Hsu, *supra* note 29, at 651-53.

39. Basic Law, *supra* note 14, art. 5, 29 I.L.M. at 1521; Fong-Chung Hsu, *supra* note 29, at 652.

40. Basic Law, *supra* note 14, art. 110, 29 I.L.M. at 1537; Fong-Chung Hsu, *supra* note 29, at 652-53.

41. Basic Law, *supra* note 14, art. 110, 29 I.L.M. at 1537; Fong-Chung Hsu, *supra* note 29, at 653.

42. *All Eyes on China*, THE ECONOMIST, June 28, 1997, at 21, available at http://www.economist.com/displayStory.dfm?Story_ID=150705.

The Basic Law, however, possessed two critical qualifications to Hong Kong's autonomy.⁴³ First, China's NPC was granted with the final authority in matters concerning the interpretation of the provisions of the Basic Law.⁴⁴ Hence, the scope of Hong Kong's autonomy would therefore be dependent upon the decision-making authority of the Beijing government.⁴⁵ Second, while the Basic Law granted Hong Kong broad economic freedom, it also commanded that the territory operate on a balanced budget.⁴⁶ This stipulation gave China's NPC the authority to monitor Hong Kong's fiscal operations and to approve of its annual budget. Thus, China's NPC had gained "considerable de facto power over Hong Kong's budget process and, ultimately, over Hong Kong's choice of economic priorities."⁴⁷

In an effort to mitigate the fears of the Hong Kong people and international community arising from the grants of authority to China mentioned above, the Basic Law explicitly reinforced its stated objective that Hong Kong would continue to maintain its esteemed reputation as an international center for trade, commerce and finance.⁴⁸ The Basic Law also stipulated that China would continue to maintain a "free flow of capital within, into and out of the Region," free of any governmental intervention from China's NPC.⁴⁹ Furthermore, the Basic Law made it clear that "no foreign exchange control policies" would be applied in the Hong Kong SAR.⁵⁰ Moreover, the Basic Law provided that Hong Kong would continue to pursue a policy of free trade in safeguarding the free movement of goods, intangible assets, and capital.⁵¹

The Basic Law further touched upon issues of human rights in that it guaranteed the right of the Hong Kong people to such democratic values as freedom of speech, press, assembly, and religion.⁵² It also provided that the Hong Kong people would have the right to challenge government decisions through the means of

43. Hagelin, *supra* note 28, at 714.

44. *Id.* Basic Law, *supra* note 14, art. 158, 29 I.L.M. at 1545.

45. Hagelin, *supra* note 28, at 714.

46. *Id.*; Basic Law, *supra* note 14, art. 107, 29 I.L.M. at 1537.

47. Hagelin, *supra* note 28, at 714-15.

48. Basic Law, *supra* note 14, art. 109, 29 I.L.M. at 1537.

49. Basic Law, *supra* note 14, art. 112, 29 I.L.M. at 1537; Hagelin, *supra* note 28, at 714-15.

50. Basic Law, *supra* note 14, art. 112, 29 I.L.M. at 1537; Hagelin, *supra* note 28, at 714-15.

51. Basic Law, *supra* note 14, art. 115, 29 I.L.M. at 1537; Hagelin, *supra* note 28, at 714-15.

52. Basic Law, *supra* note 14, arts. 26-42, 29 I.L.M. at 1525-27; *All Eyes on China*, *supra* note 42.

its judiciary branch.⁵³ Therefore, "just about everything denied to Chinese citizens [was] being promised to Hong Kong."⁵⁴ Essentially, the Beijing government had promised, through its promulgation of the Basic Law, that it would not interfere with the sovereignty of Hong Kong's "rule of law," market economy, and democratic values.

At the strike of midnight on June 30, 1997, the whole world watched with nervous excitement as the island of Hong Kong peacefully reverted back to Chinese sovereignty, and the experiment of a "one country, two systems" paradigm became a reality for the governments of China and Hong Kong. Since the eve of Hong Kong's reunification with China, the international community has observed Hong Kong's market with a watchful eye and have attempted to decipher the implications of this former British colony's passage to Chinese sovereignty on its marketplace. The international community has since focused its concerns on the question of whether China's Communist government would truly endeavor to fulfill its obligations as specified under its 1984 Joint Declaration with Britain and Hong Kong's Basic Law.⁵⁵ There is, however, still the concern over the question that even if China does fulfill its obligations pursuant to its international agreement with Britain and Hong Kong's Basic Law, will China's corrupt government exploit Hong Kong's capital market for its own short-term financial gains? These concerns are at the heart of the main issue: whether China wants its "one country, two systems" paradigm to succeed, or whether instead, China will attempt to further its nationalistic objectives of having Shanghai replace Hong Kong as the country's primary financial center.

III. THE REGULATORY REGIME

The development of Hong Kong's regulatory regime was a direct result of the stock market crashes of 1973 and 1987, which adversely affected the Hong Kong Stock Exchange's international reputation and eroded confidence in the Hong Kong market.⁵⁶ The regime consisted of a two-tier approach to the regulation of Hong Kong's securities market – the Securities and Futures

53. Basic Law, *supra* note 14, art. 35, 29 I.L.M. at 1526; *All Eyes on China*, *supra* note 42.

54. *All Eyes on China*, *supra* note 42.

55. Basic Law, *supra* note 14, pmbl, 29 I.L.M. at 1520.

56. Fong-Chung Hsu, *supra* note 29, at 688-91.

Commission ("Commission") and the Hong Kong Stock Exchange ("Exchange").⁵⁷

On May 1, 1989, the Commission was established as the primary regulatory body to Hong Kong's securities market.⁵⁸ The Commission maintains the following responsibilities with respect to the market, listed in section 4 of the Securities and Futures Commission Ordinance:

- (a) to advise the Financial Secretary on all matters relating to securities and future contracts;
- (b) to enforce without prejudice the laws relating to the securities market by way of investigation and prosecution, and to ensure that persons comply with Ordinances that relate to the securities market;
- (c) to report to the Financial Secretary any reasonable suspicions of insider dealing as promulgated under Section 9 of the Securities (Insider Dealing) Ordinance;
- (d) to supervise and monitor the activities of the Stock Exchange Companies and clearing houses;
- (e) to take all necessary and reasonable steps to safeguard investors' interests relating to their dealings in the securities market;
- (f) to promote and encourage proper conduct amongst members of the Stock Exchange Companies and clearing houses and other registered persons;
- (g) to suppress illegal, dishonorable and improper practices in dealings concerning the securities market, which includes trading and the provision of investment advice as well as other services;
- (h) to promote and maintain the integrity of registered persons and encourage such persons to promulgate balanced and informed advice to their customers and the public in general;

57. *Id.* Securities and Futures Commission Ordinance, *supra* note 17, § 3.

58. Securities and Futures Commission Ordinance, *supra* note 17; Fong-Chung Hsu, *supra* note 29, at 656-57.

- (i) to review and propose legal reforms relating to the securities market;
- (j) to encourage the development of the securities market in Hong Kong and the increased use of such markets by investors in Hong Kong and elsewhere;
- (k) to promote and develop self regulation in the securities market;
- (ka) to cooperate with and assist regulatory organizations or other authorities, in Hong Kong or elsewhere, regarding the securities market, subject to the provisions of this Ordinance; and
- (l) to perform all other functions promulgated under any other Ordinance.⁵⁹

As an agency of the Hong Kong government, the Commission's activities are governed by the territory's "rule of law."⁶⁰ The legal underpinnings of this governmental agency are, however, dependent upon the discretionary authority of Governor Tung Chee-hwa, as he possesses the statutory authority to appoint and remove the agency's members⁶¹ and to determine the wages of its members.⁶² Moreover, he is empowered with the authority to issue binding directives on the Commission.⁶³ Although there exists an appeals process for dissatisfied investors, known as the Securities and Futures Appeals Panel, this Panel is similarly held accountable to the discretionary authority of the Governor.⁶⁴ There is also the Court of Final Appeal, known as the court of last resort,⁶⁵ however, the independence of this judiciary body from the powers of the Governor is deemed to be a controversial issue in Hong Kong.

The self-regulatory organization of the Exchange was borne in 1986 out of the 1980 Stock Exchanges Unification Ordinance,⁶⁶

59. Securities and Futures Commission Ordinance, *supra* note 17, § 4.

60. *Id.*

61. *Id.* §§ 5, 10-12. See also Fong-Chung Hsu, *supra* note 29, at 657.

62. Securities and Futures Commission Ordinance, *supra* note 17, § 7.

63. *Id.* § 11.

64. *Id.* § 18.

65. Securities (Insider Dealing) Ordinance (Cap. 395), §§ 31-32 (H.K. 1991), *reprinted in* Jordan & Stanley, *supra* note 17, at 331 [hereinafter Insider Dealing Ordinance]. For a more thorough discussion of the Court of Final Appeal, see *infra* Part XI.

66. Stock Exchanges Unification Ordinance (Cap. 361), § 2 (H.K. 1981), *amended* 59 of 1985, *reprinted in* Jordan & Stanley, *supra* note 17, at 295-311 [hereinafter Unification Ordinance].

which consolidated Hong Kong's four existing stock exchanges (Hong Kong Stock Exchange Limited, Far East Stock Exchange Limited, Kam Ngan Stock Exchange Limited, and Kowloon Stock Exchange Limited) into a Unified Exchange.⁶⁷ In November 1991, the Commission and Exchange signed a Memorandum of Understanding Governing Listing Matters, in which the Exchange "assume[s] responsibility for the day-to-day supervision and regulation of listed companies and the people running the financial markets with respect to all listed matters."⁶⁸ The Exchange also ensures the maintenance of a fair and orderly market⁶⁹ and is embodied with rule-making authority, subject to the Securities Ordinance, concerning securities listings and the capital adequacy requirements of its members.⁷⁰ Moreover, the Exchange maintains disciplinary authority over its listed companies and members, as it is empowered with the ability to suspend, de-list or sanction a listed company, or impose obligations against a person liable for misconduct in the securities market.⁷¹

The responsibilities of the Exchange are, however, subject to the guidance of the Commission and its rule-making authority.⁷² Hence, the Commission may direct the Exchange to amend a rule, if deemed unconstitutional under Hong Kong's securities laws, or enact a rule in furtherance of the nation's securities laws.⁷³ However, the Exchange may not enact or amend a rule without the prior approval of the Commission.⁷⁴ To enforce its supremacy as the primary rule-making authority in Hong Kong, the Commission retains the right to withdraw its recognition of the Exchange if it fails to comply with any of its duties as a self-regulatory organization.⁷⁵ Moreover, the Commission possesses unlimited policing powers in its regulation of Hong Kong's securities market.⁷⁶

This two-tier regulatory approach – the Commission and Exchange – has successfully put in place a "rule of law" that is able to efficiently govern Hong Kong's securities market. This

67. *Id.*

68. Fong-Chung Hsu, *supra* note 29, at 692.

69. Unification Ordinance, *supra* note 66, § 27A.

70. *Id.* § 34.

71. *Id.* §§ 34-35.

72. *Id.* § 34(2).

73. *Id.*

74. *Id.* § 35.

75. *Id.* § 36.

76. Securities Ordinance (Cap. 333), §§ 23-27 (H.K. 1985), amended 58 of 1985 § 32, reprinted in Jordan & Stanley, *supra* note 17, at 192-95.

regulatory regime and its laws have helped to restore investor protection and confidence in Hong Kong's securities market since the market crashes of 1973 and 1987. Hong Kong's regulatory regime is, however, susceptible to the political whims of Governor Tung Chee-hwa, who maintains discretionary authority over the regulatory functions of the Commission and Exchange.⁷⁷ Consequentially, the international community is fearful that the Governor will exploit his position to negatively impede in the effectiveness of Hong Kong's regulatory regime.⁷⁸ This is, however, highly unlikely, since a failure on the part of the Governor to abide by the expertise of the members of the Commission and Exchange would ultimately cause the integrity of Hong Kong's marketplace to become greatly diminished, thereby displacing the territory's status as an international financial center. This would, in turn, inflict great economic pain on the Beijing government, which is dependent upon the venue of Hong Kong to raise capital from the international community in order to salvage its ailing state-run economy from dissolution and insolvency and to push its economic reforms forward. Moreover, China's future relationship with neighboring Taiwan, and whether it will be able to fashion a plan of reunification similar to that of Hong Kong, will be dependent upon the success of its "one country, two systems" paradigm. Thus, Governor Tung Chee-hwa really has no choice but to leave the regulation of Hong Kong's securities market to the Commission and Exchange, as it is not in the interest of the Beijing government for him to impede in the responsibilities of the territory's regulatory regime.

IV. THE CODE ON TAKEOVERS AND MERGERS

There is no legal framework in Hong Kong regulating takeovers and mergers of public companies, as the Code on Takeovers and Mergers,⁷⁹ which was issued by the Commission in March 1992, has no legal force.⁸⁰ Instead, the Code serves as a purely voluntary doctrine, which provides guidelines for companies concerning the issue of takeovers and mergers.⁸¹ Therefore, "its effectiveness [will depend] on the attitudes of, and

77. Securities and Futures Commission Ordinance, *supra* note 17.

78. *Id.*

79. HONG KONG CODE ON MERGERS AND TAKEOVERS, § 1.

80. Fong-Chung Hsu, *supra* note 29, at 711.

81. McMurtray, *supra* note 12, at 77.

observance of it by, the participants in the securities market,"⁸² as the Takeovers and Mergers Panel has only the power to "issue a private reprimand, a public statement or public censure against offenders of the code."⁸³ Nonetheless, market participants, such as the Hong Kong Stock Exchange, have the power to sanction offenders of the Code, thereby adding some "teeth" to the doctrine.⁸⁴

The Code, all in all, mandates that:

acquirers . . . disclose information necessary for the target's shareholders to evaluate the offer and reach an informed decision. The offer must remain open for a minimum length of time and unequal offers to different shareholders are forbidden. Target boards . . . must submit bids to shareholder vote and may not take action to discourage the making or completion of bids. In practice, this means that target boards may not . . . implement defensive tactics . . . [or help] favored bidders.⁸⁵

Since the passage of Hong Kong to Chinese sovereignty, Mainland China's red chip companies have migrated to Hong Kong to list "H shares"⁸⁶ on their stock exchange, beyond the reach of Beijing's regulators whose regulation of takeovers and mergers is far more extensive than that of Hong Kong.⁸⁷ As a result of this mass exodus of Chinese companies, the Beijing government has reasserted its control over the Hong Kong takeover process by necessitating its consent to all takeovers and mergers involving public utilities, infrastructure, and telecommunications.⁸⁸ Moreover, according to Hong Kong's Basic Law, the Beijing government has expressly reserved its right to intervene in situations involving issues of national security.⁸⁹

82. Fong-Chung Hsu, *supra* note 29, at 712 (quoting Alan Au, *Hong Kong Code on Takeovers and Mergers & Toothless Watchdog or Handmaiden of Equality*, 17 H.K.L.J. 24, 26-27 (1987)).

83. *Id.* at 712.

84. McMurtray, *supra* note 12, at 78.

85. *Id.* at 79.

86. Mo Zhang, *China's New Securities Law: An Effort to Create Markets that are Open and Equitable*, 21 E. ASIAN EXEC. REP. 9 (1999) ("H-shares" are shares denominated in foreign currencies and registered in China, but issued and traded in Hong Kong.).

87. McMurtray, *supra* note 12, at 80.

88. *Id.* at 90 (citations omitted).

89. *Id.* at 89 (citation omitted). See also Basic Law, *supra* note 14, art. 18, 29 I.L.M. at 1523.

Hence, it has retained the undisputed authority to impede in a takeover or merger on the grounds that the transaction would adversely affect its national interests, thus softening the nation's "fears that state assets were leaking away to foreign investors."⁹⁰

The takeover and merger process in Hong Kong has been further impeded by China's employment of "different and often less stringent accounting standards," which are non-compliant with internationally accepted standards.⁹¹ Hong Kong, who, as a member of the General Agreement on Tariffs and Trade ("GATT") and the World Trade Organization ("WTO"), uses accounting principles that are in compliance with internationally accepted standards, this is in sharp contrast to China's substandard accounting standards.⁹² In the short-run, the less stringent accounting standards of Mainland China's enterprises will serve to hamper Hong Kong's takeover and merger process by causing the valuation of China's enterprises to be either undervalued or overvalued, and perhaps even to contain some hidden liabilities, thereby scaring many investors away. However, in the long-run, China's enterprises which choose to list on the Hong Kong Stock Exchange, will be forced to change their accounting standards so that they are in compliance with the generally accepted accounting standards of the international community. Thus, this is not a problem that should jeopardize the future status of Hong Kong's marketplace, as it is merely a bump in the road that will, either sooner or later, be overcome by the desire of China to do business with the international community.

Another potentially disturbing problem concerning the takeover and merger process in Hong Kong involves the corruption that is instilled into Mainland China's companies. Market insiders are fearful that well-connected Chinese companies will receive special treatment from Hong Kong's regulators.⁹³ They particularly fear that the Takeover Committee will fail to fully enforce the Code against Mainland China's companies that willfully violate the Code by either leaking out confidential information to favored parties, failing to disclose required information to disfavored parties, or exploiting defensive tactics.⁹⁴ Although "[w]ell-connected firms and individuals . . .

90. *Id.* (quoting Renee Lai, *Overseas Activity in M&A 'Alive and Well'*, S. CHINA MORNING POST, Feb. 23, 1996, at 3).

91. McMurray, *supra* note 12, at 83.

92. *Id.*

93. *Id.* at 86-87 (quoting Mark Clifford, *Can Hong Kong Learn to Behave?*, BUS. WK., Sept. 2, 1996, at 42).

94. *Id.* at 87 (citation omitted).

might benefit in the short term from the Code's erosion . . . in the long run the adverse effect of lost investor confidence would probably overwhelm the short term advantages.⁹⁵

Since Hong Kong's Code on takeovers and mergers does not possess any statutory force, rendering it incapable of imposing civil or criminal liability on its violators, the burden rests on the Takeover Committee and market participants (i.e., Hong Kong Stock Exchange) to enforce its guidelines.⁹⁶ Any failure on the part of the Takeover Committee and market participants to enforce the Code in a fair and impartial manner would result in the Code's erosion, causing the integrity of Hong Kong's marketplace to become greatly diminished. Hence, the Beijing government has a national interest in the viability of the Code, as the undermining of it would only serve to displace Hong Kong's status as an international financial center. This would, in turn, inflict great economic pains on the Beijing government, which is dependent upon the venues of Hong Kong to raise foreign capital for its debt-ridden state-run economy, and to implement its economic reforms.⁹⁷ Moreover, the erosion of the Code would prove futile to China's "one country, two systems" paradigm, which would be devastating to the Beijing government's objective of being able to fashion a plan of reunification with neighboring Taiwan on terms similar to that of Hong Kong. Thus, Hong Kong's Governor, Tung Chee-hwa, must make it his personal responsibility to ensure that the Code is enforced in a fair and impartial manner, irrespective of personal relationships that may exist between Mainland China's companies and government regulators. Even though a vast opportunity exists for Chinese meddling in Hong Kong's takeover and merger process, the Beijing government should be reluctant to intervene as a *laissez-faire* policy would be in the best interests of the Hong Kong securities market as well as Mainland China.

95. *Id.* at 95.

96. *Id.* at 77. Furthermore, the Takeovers Committee administers the Code pursuant to Section 16 of the Securities Ordinance, which allows the Securities Commission to establish and delegate responsibility to committees that may regulate their own procedure as they see fit. DEREK J.M. MURPHY, A GUIDE TO THE HONG KONG CODE ON TAKEOVERS AND MERGERS 4, 5 (1988). See also H. LEIGH FRENCH, INTERNATIONAL LAW OF TAKEOVERS AND MERGERS: ASIA, AUSTRALIA, AND OCEANIA 64, 93 (1986).

97. Cao, *supra* note 21.

V. HONG KONG'S POLICY OF *LAISSEZ-FAIRE* ECONOMICS VERSUS CHINA'S POLICY OF GOVERNMENT INTERVENTION

Hong Kong's government has long been recognized as a territory with a government that advocates a policy of *laissez-faire* economics⁹⁸ towards its marketplace.⁹⁹ Therefore, market forces, not State directives, are expected to determine the valuation of the territory's stock market. It is this non-interventionist style of government that has contributed to the long-standing integrity of Hong Kong's marketplace and its renowned status as an international finance center. Since the return of Hong Kong to Chinese sovereignty, however, Hong Kong's policy of *laissez-faire* economics appears to have subsided in favor of government intervention as a strategy for dealing with the market's troubles.¹⁰⁰

During the summer of 1998, hedge funds and investment banks were selling Hong Kong dollars, thus causing interest rates to skyrocket and the stock market to decline.¹⁰¹ During this market trend, the hedge funds and investment banks were also selling the stock market short, thereby making a killing in the market.¹⁰² Consequentially, however, this trading activity led to an atmosphere of increased market speculation on the Hong Kong Stock Exchange.¹⁰³ Hence, Governor Tung Chee-hwa intervened, without the consent of the legislature, by ordering Hong Kong's central bank – the Hong Kong Monetary Authority – to buy up shares in the market.¹⁰⁴ In the end, the Hong Kong Monetary Authority's buying spree dwarfed all other buyers on the Hong Kong Stock Exchange as it purchased HK \$118 billion (US \$15.1 billion) and became the largest shareholder in some of the territory's most prestigious blue-chip companies.¹⁰⁵ Thereafter, the Governor justified his interventionist style of government by claiming that its purchases achieved their specific objective of

98. THE AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE 981 (4th ed. 2000) ("*Laissez-faire*" is "[a]n economic doctrine that opposes governmental regulation of an interference in commerce beyond the minimum necessary for a free-enterprise system to operate according to its own economic laws."); BLACK'S LAW DICTIONARY 880-81 (7th ed. 1999) ("[French 'let (people) do (as they choose)'], Governmental abstention from interfering in economic or commercial affairs.").

99. 3F HAROLD S. BLOOMENTHAL & SAMUEL WOLFF, SECURITIES & FEDERAL CORPORATE LAW § 27:18 (2d ed. 2000).

100. *Market Force*, THE ECONOMIST, Aug. 22, 1998, at 57. See also *Making Tracks*, THE ECONOMIST, Oct. 9, 1999, at 90.

101. *Market Force*, supra note 100, at 57; *Making Tracks*, supra note 100, at 90.

102. *Market Force*, supra note 100, at 57; *Making Tracks*, supra note 100, at 90.

103. *Market Force*, supra note 100, at 57; *Making Tracks*, supra note 100, at 90.

104. See generally *Making Tracks*, supra note 100.

105. *Id.* at 79.

successfully putting a halt to market speculation, which was directly attributable to the territory's hedge funds and investment banks.¹⁰⁶

Although the Hong Kong government was able to ruin this moneymaking scheme, while simultaneously profiting from its dealings, its shift in policy from *laissez-faire* economics to government intervention blemished the credibility of the territory's market.¹⁰⁷ Despite the Hong Kong government's promise to sell its shares back to the private sector, thereby putting to rest the world's fears of Hong Kong becoming transformed into a state-run economy, this instance of government intervention caused bona fide investors to steer clear of Hong Kong's stock market.¹⁰⁸ Subsequently, investors found it more difficult to decipher what lay behind the price movements in Hong Kong's stock market – whether it was market forces or the interventionist policy of the State.¹⁰⁹ Consequentially, Hong Kong's stock market experienced decreased market liquidity and increased market speculation and volatility since investment decisions were being premised, no longer solely on market factors, but instead, on government policy as well.¹¹⁰

Hong Kong's image was further wounded by the “intolerable conflicts of interest” that was generated by its government's dealings in the stock market.¹¹¹ For instance, the government became the owner of 8.8% of HSBC, the largest bank in Hong Kong, which was regulated by the Hong Kong Monetary Authority.¹¹² The government also became the “owner of nearly 12% of New World Development and of more than 10% of Cheung Kong, two giant property conglomerates,” while having the role as the sole supplier of fresh land for development in Hong Kong.¹¹³ Thus, the most troubling notion about Governor Tung Chee-hwa's decision to intervene in its stock market was the issue of insider trading, as the government's dealings created an overlap between the public and private sectors.¹¹⁴ The Hong Kong government has, however, since redeemed itself in the eyes of the world by selling its ownership of the shareholding companies back to the

106. *Fair Shares*, THE ECONOMIST, Oct. 31, 1998, at 79.

107. *Fashionable*, THE ECONOMIST, Sept. 5, 1998, at 67.

108. *Market Force*, *supra* note 100.

109. *Id.*

110. Since you have the source, I don't know if this statement either came from the actual source, or was an independent thought.

111. *Making Tracks*, *supra* note 100.

112. *Fair Shares*, *supra* note 106.

113. *Id.*

114. *Id.*

private sector and employing alternative non-interventionist means (i.e., its rule-making authority) for fighting market speculation.¹¹⁵

China must realize that any further abandonment of Hong Kong's long-treasured policy of *laissez-faire* economics in favor of its own policy of government intervention would greatly diminish the integrity of Hong Kong's marketplace, possibly causing the territory to return to its historical prospects as a "barren" island. These are ramifications that the Beijing government cannot afford to endure as Hong Kong's marketplace is crucial to Mainland China's doorway to the world's capital,¹¹⁶ particularly since its state-run economy faces the difficult issue of financial insolvency and potential bankruptcy,¹¹⁷ and its economic reforms are in dire need of funding. Moreover, the Beijing government must comply with Hong Kong's policy of *laissez-faire* economics if it seriously wants its "one country, two systems" paradigm to succeed, which is essential to its ability to fashion a plan of reunification with neighboring Taiwan on terms similar to that of Hong Kong.

VI. HONG KONG'S INDEPENDENT COMMISSION AGAINST CORRUPTION

Corruption is like a "heavy tax" on a nation's economic activity.¹¹⁸ It serves to weaken private markets as it "misallocates economic resources and creates inefficiencies in market competition" by distorting the competitive equilibrium and supply and demand factors.¹¹⁹ Aside from being the politically irritating and destabilizing force behind a regime's monetary and fiscal policies, it serves to deter foreign investors from risking their money in a nation's market. Hong Kong, however, has so far been able to remain remarkably free of corruption through the establishment of the ICAC in 1974.¹²⁰ The ICAC has since been preserved, by Article 57 of the Basic Law, following Hong Kong's passage to Chinese sovereignty.¹²¹

The ICAC can be expected to be the most seriously tested of all the governmental organizations following the passage of Hong

115. *Fashionable*, *supra* note 107.

116. BLOOMENTHAL & WOLFF, *supra* note 100 (Hong Kong "serve[s] as a revolving door for a mainland China reaching out to the West for technological assistance and investment and for Western industry seeking to exploit Chinese markets.").

117. Cao, *supra* note 21.

118. PATTEN, *supra* note 6, at 224.

119. Hagelin, *supra* note 28, at 726.

120. *Id.* at 727.

121. *Id.* at 728. See also Basic Law, *supra* note 14, art. 57, 29 I.L.M. 1530.

Kong to Chinese sovereignty, as corruption is fluid in Mainland China.¹²² This corruption is attributable to the overlap between the Beijing government and private sector,¹²³ which, in turn, has made personal relationships the cornerstone of that nation's economic activity.¹²⁴ This corruption, which has been culturally instilled in Mainland China's companies, will certainly impact Hong Kong's marketplace through their listings on the Hong Kong Stock Exchange. Thus, the viability of the ICAC shall prove to be crucial to the maintenance of Hong Kong's corrupt-free market.

However, the legitimacy of the ICAC is under threat as Article 57 of the Basic Law has raised a potential conflict of interest by making the activities of the organization accountable to Hong Kong's Governor Tung Chee-hwa.¹²⁵ Hence, the Governor is wearing two hats. On one hand, the Governor, as a political appointee of the Beijing government, is a representative of the interests of Mainland China's enterprises that have listed on the Hong Kong Stock Exchange. On the other hand, he possesses a defining role in the ICAC, whose sole objective is to fight corruption in Hong Kong's marketplace.¹²⁶ Consequently, Hong Kong's remarkably corrupt-free society is lingering on the sanctity of the ICAC, which is dependent upon the Governor's seriousness in preserving a corrupt-free Hong Kong.¹²⁷

China's motivation to fight corruption in Hong Kong is founded on its need to maintain the long-standing integrity of Hong Kong's marketplace and its status as an international financial center, as it is dependent upon the venues of Hong Kong to raise capital from the international community. Its motivation is also founded on its bid to ensure the success of its "one country, two systems" paradigm, which is essential to its ability to fashion a plan of reunification with neighboring Taiwan on terms similar to that of Hong Kong. Thus, Hong Kong's Governor Tung Chee-hwa has every incentive to oversee the conduct of the ICAC, free of any influence from his personal relationships with Mainland China, with the vision of maintaining the "rule of law" in Hong Kong, which explicitly prohibits practices of corruption in its marketplace.

122. *Id.*

123. Brian Daly, *Of Shares, Securities, and Stakes: The Chinese Insider Trading Law and the Stakeholder Theory of Legal Analysis*, 11 AM. U. J. INT'L L. & POL'Y 971, 1008 (1996).

124. Hagelin, *supra* note 28, at 726.

125. *Id.*

126. *Id.*

127. *Id.* at 727.

VII. MEDIA FREE HONG KONG

"The free exchange of business information and ideas is essential to the operation of a market economy,"¹²⁸ as the democratic right to a free-media promotes transparency and openness in the market.¹²⁹ People cannot be expected to invest wisely in a stock market if they are restricted in the news that they can read or the opinions that they can advance, and if the information is inaccurate in consideration of the government's policy of censorship.¹³⁰ Thus, a toleration of free press and speech are essential ingredients to a country's race for economic growth.¹³¹

In direct contravention to China, Hong Kong's Basic Law guarantees to its citizens the democratic values of free speech and press.¹³² In turn, this has laid down the foundation for a more transparent, open and healthier business environment in Hong Kong. However, these democratic rights are vulnerable to the political whims of Hong Kong's Governor, Tung Chee-hwa.¹³³ For instance, Hong Kong's Ordinances allocate to the Governor the right to seize and censor information if exercised in the public interest.¹³⁴ The Governor is also empowered with the right to control the flow of information, since the territory has no "Freedom of Information Law."¹³⁵ Furthermore, the Governor is empowered, pursuant to the Emergency Regulations Ordinance,¹³⁶ with the authority to enact regulations restricting the territory's freedom of speech and press, as long as it is exercised in line with the objective of maintaining public order.¹³⁷ These statutory restrictions on the citizens of Hong Kong's right of free speech and press have placed fear into the hearts of the international community and people of Hong Kong; although, they have yet to come to light since Hong Kong's passage to Chinese sovereignty.¹³⁸

The transparency and openness of Hong Kong's market has, however, dissipated since its return to Chinese sovereignty. First,

128. *Id.* at 725.

129. PATTEN, *supra* note 6, at 234.

130. *Id.*

131. *Id.* at 177.

132. Basic Law, *supra* note 14, art. 27, 29 I.L.M. at 1525.

133. Richard Cullen, *Media Freedom in Chinese Hong Kong*, 11 TRANSNAT'L LAW. 383, 396 (1998).

134. PATTEN, *supra* note 6, at 177.

135. Cullen, *supra* note 133, at 397.

136. (Cap. 241) (H.K.); Cullen, *supra* note 133, at 398.

137. Basic Law, *supra* note 14, art. 18, 29 I.L.M. at 1523; Cullen, *supra* note 133, at 398.

138. Cullen, *supra* note 133, at 416-18.

"[t]here is no doubt that self-censorship is practiced [sic] by the Hong Kong media."¹³⁹ This is particularly true with respect to Hong Kong's reporters and writers, who are responsible for the coverage of companies from Mainland China, as they are reluctant to publish a negative story for fear of being arrested and punished by the Beijing government.¹⁴⁰ Second, there has been a sudden lack of media access to Hong Kong's government, as well as an increased secrecy in the territory's judiciary branch.¹⁴¹ Of course, there is also the continuing concern that the transparency and openness of Hong Kong's market will dissipate further as companies from Mainland China start to buy into the territory's media, which has already occurred with respect to Hong Kong Television Broadcaster, ATV.¹⁴² Nonetheless, Hong Kong is presently the greatest example of a nation's exercise of its freedom of speech and press as every international paper and electronic media currently maintains operations in Hong Kong, and the territory enjoys the most news media per heads of population than any area in the world.¹⁴³

Although Governor Tung Chee-hwa has the legal authority to restrict Hong Kong citizens' democratic right to a media-free Hong Kong, it would be unwise for him to implement such a program of government censorship because the effect would translate into financial suicide for the Beijing government. First, government censorship in Hong Kong would only serve to diminish the integrity of its marketplace, causing investors to pull their funds out of Hong Kong and thereby closing the gates to China's doorway to the world's capital. Second, it would foreclose on any chance that China may have in exploiting the success of its "one country, two systems" paradigm during its negotiations with neighboring Taiwan concerning a plan of reunification of similar terms to that of Hong Kong. Thus, to the extent that China's economy is dependent upon the success of its "one country, two systems" paradigm, the Beijing government will not stray from its guarantee of the democratic values of a free press and speech, as provided under the terms of Hong Kong's Basic Law.

VIII. DISCLOSURE IN THE MARKETPLACE

To create a more level playing field among market participants so as to lessen the information deficit between

139. *Id.* at 407.

140. *Id.* at 407-08.

141. *Id.*

142. *Id.* at 409.

143. *Id.*

companies and investors and to break the manager's monopoly over corporate information, the law in Hong Kong requires that public companies and shareholders disclose certain information to the public. For instance, the Securities (Disclosure of Interests) Ordinance¹⁴⁴ imposes a mandatory disclosure requirement on shareholders who have acquired a greater than ten percent interest in a company's shares.¹⁴⁵ The objective of the Ordinance is to provide the investment community with a list as to the identity of company shareholders that are able to exert a control or influence over the company's policies to better enable investors to make their investment decisions.¹⁴⁶

In addition to the shareholder disclosure requirement, the Companies Ordinance requires that a company offering shares to the public issue a prospectus,¹⁴⁷ which offers to the investing public a full description of the company and its share offering.¹⁴⁸ A public company is required to update its prospectus every six months and issue a company report on an annual basis.¹⁴⁹ Moreover, there is a continuing obligation on a public company to publish material events when they occur, including information concerning the company's financial position, information sufficient to allow the public to make reasoned decisions about their market investments.¹⁵⁰

The information disclosed, whether it is mandatory or voluntary, must be accurate, and therefore, not misleading.¹⁵¹ To ensure the accuracy of a prospectus, Hong Kong's laws require that an auditor, who is to be at arms-length from the company, issue a report, which states that the prospectus represents a "true and fair view" of the company's affairs.¹⁵² However, there exists great controversy in Hong Kong as to what constitutes a "true and

144. (Cap. 396) (H.K. 1991), *reprinted in* Jordan & Stanley, *supra* note 17, at 336-86 [hereinafter *Disclosure Ordinance*].

145. *Id.* §§ 3-6.

146. Fong-Chung Hsu, *supra* note 29, at 700.

147. Companies Ordinance (Cap. 32) (H.K. 1974), §§ 37-41A, *reprinted in* Jordan & Stanley, *supra* note 17, at 66-77 [hereinafter *Companies Ordinance*]; John T. Shinkle, *Observations on Capital Market Regulation: Hong Kong and The People's Republic of China*, 18 U. PA. J. INT'L ECON. L. 255, 272 (1997).

148. Companies Ordinance, *supra* note 147, 3d sched.; Fong-Chung Hsu, *supra* note 29, at 701.

149. Fong-Chung Hsu, *supra* note 29, at 706.

150. *Id.*

151. Securities Ordinance (Cap. 333) (H.K. 1985), *reprinted in* Jordan & Stanley, *supra* note 17, at 177-276 [hereinafter *Securities Ordinance*]; Protection of Investors Ordinance (Cap. 335) (H.K. 1974), *reprinted in* Jordan & Stanley, *supra* note 17, at 277-94 [hereinafter *Protection of Investors Ordinance*]; Fong-Chung Hsu, *supra* note 29, at 701.

152. Fong-Chung Hsu, *supra* note 29, at 702. *See also* Companies Ordinance, *supra* note 147, 3d sched.

fair view" of a company's affairs.¹⁵³ The Commission has no obligation to ensure the accuracy of a company's prospectus prior to approving its issuance to the public, but it does maintain the authority to refuse to register a prospectus if it believes the information to be inaccurate.¹⁵⁴ In the Hong Kong government's commitment to maintaining the veracity of a company's prospectus, its legislature has allocated civil and criminal penalties to parties liable for the publication of an inaccurate statement in their company's prospectus.¹⁵⁵

Hong Kong's mandatory disclosure requirements for public companies and shareholders have promoted a greater transparency and openness in the territory's marketplace, thereby improving investor confidence in the market. However, a failure on the part of the Hong Kong government to enforce its disclosure requirements would greatly diminish the long-standing integrity of its marketplace, thereby causing investor confidence to plummet and China's doorway to the world's capital to dry up. Although in the short-run, the Hong Kong government's refusal to enforce its disclosure requirements could prove fruitful, enabling managers to profit as a result of their monopoly over corporate information in Hong Kong, in the long run, the ramifications of such a policy would outweigh any such benefits. Thus, Hong Kong's Governor Tung Chee-hwa, must ensure that the regulations regarding corporate and investor disclosure are enforced in the marketplace, as it is a significant variable in maintaining Hong Kong's status as an international financial center. It is also vital to the success of Beijing's "one country, two systems" paradigm, which is crucial to China's desire to fashion a plan of reunification with neighboring Taiwan on terms similar to that of Hong Kong.

IX. INSIDER DEALING

Hong Kong's securities laws explicitly make it unlawful for a *tipper* or *tippee* to commit a transaction that involves insider dealing of a listed security of a corporation.¹⁵⁶ A three-member

153. Companies Ordinance, *supra* note 147, § 41A; Fong-Chung Hsu, *supra* note 29, at 702.

154. Companies Ordinance, *supra* note 147, §§ 31A, 38D(5)(b), 40, 40A; Fong-Chung Hsu, *supra* note 29, at 702

155. Companies Ordinance, *supra* note 147, §§ 38(4), 40, 40(a), 342E, 342F; PAULINE WALLACE, COMPANY LAW IN HONG KONG 48, 51 (2d ed. 1990); Fong-Chung Hsu, *supra* note 29, at 705. See also Securities and Exchange Commission, A Draft for a Composite Securities and Futures Bill (H.K., Apr. 1996), §§ 13.4(1), 13.8, 13.4(3).

156. Insider Dealing Ordinance, *supra* note 65, § 9(1)-(2). Hong Kong's legislature narrowly defined the classifications of a *tipper* and *tippee* in its Insider Dealing Ordinance in the following manner:

Insider Dealing Tribunal is the governmental body responsible for the handling of the investigation and hearing of all alleged violations of insider dealing.¹⁵⁷ The powers of the Tribunal are unlimited with respect to its investigation of alleged insider dealing violations, as it may impose either a fine or imprisonment on anyone who dares to obstruct the investigation process.¹⁵⁸ During the hearing stage, the alleged violators of Hong Kong's insider dealing laws are allocated their "due process" right to be heard by the Tribunal.¹⁵⁹

Once the Tribunal has rendered its ruling, the party convicted of insider dealing may receive any or all of the following judicially imposed punishments:

- (a) an order that [the] person shall not, . . . be a director or a liquidator or a receiver of manager of the property of a listed company or any other specified company or in any way, whether directly or indirectly, . . . take part in the management of a listed company or any other [such] company for [a] period (not exceeding 5 years) . . . ;
- (b) an order that [the] person pay to the Government an amount not exceeding the amount of any profit gained or loss avoided . . . result[ing from] the insider dealing;
- (c) an order imposing . . . a penalty of an amount not exceeding three times the amount of any

(1) Insider dealing in relation to the listed securities of a corporation takes place-

- (a) when a person [i.e. tipper] connected with a corporation who is in possession of information which he knows is relevant information in relation to that corporation deals in any listed securities of that corporation (or in the listed securities of a related corporation) or counsels or procures another person [i.e. tippee] to deal in such listed securities knowing or having reasonable cause to believe that such person would deal in them; . . .

Id. § 9(1)(a).

The United States judiciary has commonly defined the terms "tipper" and "tippee" and their legal responsibilities in *United States v. O'Hagan*, 521 U.S. 642 (1997), and *Dirks v. S.E.C.*, 463 U.S. 646 (1983). Under Rule 10b-5, a "tippee" is someone who "assumes fiduciary duty to shareholders of corporation not to trade on material nonpublic information only when insider [otherwise referred to as a tipper] has breached his fiduciary duty to shareholders by disclosing information to tippee, and tippee knows or should know that there has been a breach." *Id.* See also Securities Exchange Act of 1934, § 14(e), 15 U.S.C.A. § 78n(e); and 17 C.F.R. § 240.14e-3(a).

157. Insider Dealing Ordinance, *supra* note 65, § 15.

158. *Id.* §§ 20-27.

159. *Id.* § 16.

profit gained or loss avoided by any person . . .
result[ing from] the insider dealing.¹⁶⁰

Once there has been an adverse finding by the Tribunal, the convicted party will have the right to appeal the Tribunal's ruling to the Court of Final Appeal.¹⁶¹

Hong Kong's explicit prohibition of insider dealing is weakened, however, by the fact that it fails to criminalize these transactions. Instead, the Tribunal is only permitted, by law, to impose a punishment of civil liability on violators of Hong Kong's insider dealing provisions.¹⁶² Even though the criminalization of insider dealing would raise the burden of proof for the prosecutor, it would demonstrate the seriousness of the government's efforts to battle insider dealing, while maintaining in tact civil penalties, which carry a lesser burden of proof.

This issue of insider dealing poses a serious threat to the integrity of Hong Kong's stock market, a threat that the international community fears will be magnified because of the passage of Hong Kong to Chinese sovereignty. China is renown for its insider dealing violations as the overlap between the government and private sector has made personal relationships the cornerstone of that nation's economic activity.¹⁶³ The seriousness of this concern is what gave rise to the Chairman of the Commission's "salutary warning that Hong Kong should not allow itself to become, the Wild West of the Far East."¹⁶⁴

It is imperative that the Hong Kong government, under the leadership of Governor Tung Chee-hwa, uphold the territory's "rule of law," which explicitly prohibits insider dealing in its stock market.¹⁶⁵ By doing so, Mainland China will be sacrificing its short-term insider dealing profits for the long-term viability of the market's integrity and its status as an international financial center. Irrespective of the fact that this goes against Mainland China's cultural acceptance of insider dealing, the enforcement of Hong Kong's insider dealing laws is a prerequisite to the success of China's "one country, two systems" paradigm. Otherwise, anything short of fair and equitable shareholder treatment in Hong Kong's stock market would provoke the investment community to pull their money out of Hong Kong, thereby closing

160. *Id.* § 23(1)(a)-(c).

161. *Id.* § 31.

162. *Id.* § 17; Fong-Chung Hsu, *supra* note 29, at 708.

163. Daly, *supra* note 123, at 1008.

164. PATTEN, *supra* note 6, at 228.

165. Insider Dealing Ordinance, *supra* note 65.

the gates to China's doorway to the world's capital. Thus, China has little choice but to comply with the enforcement of Hong Kong's insider dealing laws as its state-run economy is in dire straits and its economic reforms are in need of funding from the international community. Moreover, the success of China's "one country, two systems" paradigm is at stake if China refuses to comply with the enforcement of Hong Kong's insider dealing provisions, thereby jeopardizing its goal of fashioning a plan of reunification with neighboring Taiwan on similar terms similar to those of Hong Kong.

X. PRIVATE LITIGATION

"[E]ffective private remedies have proved [to be] an indispensable and essential part" of securities law enforcement.¹⁶⁶ Private remedies not only help to compensate defrauded investors, but they also provide deterrence against securities fraud and other misconduct.¹⁶⁷ Furthermore, they provide "[d]irect incentives . . . for victimized investors to detect, report, and assist in the apprehension [and prosecution] of violators,"¹⁶⁸ thereby supplementing the enforcement activities of the regulatory bodies, which are under-staffed and under-trained, to clean up the abuses of the securities market.¹⁶⁹ "Without a private right of action, individual shareholders are without redress for egregious, even criminal, behavior on the part of [company] management."¹⁷⁰ Thus, a government that is serious about the enforcement of its securities laws must explicitly render to its shareholders the ability to raise a private cause of action against a listed company and its officers and directors.

The law in Hong Kong empowers a shareholder with the right to bring forward a private cause of action against a person, who, "by any fraudulent, reckless, or negligent misrepresentation, induces another person— . . . to acquiring, disposing of, subscribing for, or underwriting securities" for the purpose or effect of securing a profit.¹⁷¹ If found liable, that person shall be required to pay compensation to the injured shareholder for his pecuniary

166. Wenhai Cai, *Private Securities Litigation in China: Of Prominence and Problems*, 13 COLUM. J. ASIAN L. 135, 136 (1999).

167. *Id.*

168. *Id.* at 142.

169. *Id.* at 139.

170. Daniel M. Anderson, *Taking Stock in China: Company Disclosure and Information in China's Stock Markets*, 88 GEO. L.J. 1919, 1940 (2000).

171. Protection of Investors Ordinance, *supra* note 151, § 8(1)(a)(i).

loss.¹⁷² The law in Hong Kong also entitles a shareholder to bring forward a private cause of action, seeking compensation for any pecuniary loss that he may have suffered as a result of his reliance on a "false, misleading, or deceptive" statement in his purchase or sale of shares.¹⁷³

These two express private rights of action serve to safeguard the interests of the investor in the Hong Kong stock market, thereby increasing investor confidence in the market. Irrespective of the fact that a shareholder's private right of action goes against Mainland China's Marxist ideology, Hong Kong's Governor, Tung Chee-hwa, must nevertheless maintain this measure of investor recourse in its stock market since investor protection and confidence is vital to the success of Hong Kong's market. Thus, any decision by the Beijing government to repeal the shareholder's private right of action in Hong Kong's stock market would only serve to undermine its status as an international financial center. Moreover, it would inflict harm on China's bid for a successful "one country, two systems" paradigm, thereby ruining its government objective of being able to fashion a plan of reunification with neighboring Taiwan on similar terms to those of Hong Kong.

XI. THE JUDICIARY BRANCH AND WHETHER IT IS INDEPENDENT OF BEIJING

Financial systems cannot exist without adequate legal institutions, as a nation's market requires a viable judiciary branch to interpret and enforce the laws of the land. A judiciary branch is an indispensable part of government whose primary purpose is for the protection of the "rule of law," an essential ingredient to a country's economic success.¹⁷⁴ The ability of the judiciary branch to enforce the "rule of law" and to challenge the government when it actively violates a nation's laws is vital to a healthy business environment.¹⁷⁵

As a safeguard to the viability of the Hong Kong's judiciary branch, the Court of Final Appeal was established as "the ultimate guarantor" of Hong Kong's legal system.¹⁷⁶ However,

172. *Id.* § 8(1).

173. Fong-Chung Hsu, *supra* note 29, at 704. See also Insider Dealing Ordinance, *supra* note 65, § 8.

174. John McDermott, *The "Rule of Law" in Hong Kong After 1997*, 19 LOY. L.A. INT'L & COMP. L. J. 263, 275 (1997).

175. *Id.*

176. *Hong Kong Diminished*, THE ECONOMIST, July 1, 1999, at 16.

market insiders are fearful that Hong Kong's judiciary branch will succumb to external pressures from Beijing in its interpretation, and essentially, its enforcement of Hong Kong's "rule of law," thereby giving preferential treatment to Mainland China's companies.¹⁷⁷ This fear is well-founded in that the Basic Law explicitly holds Hong Kong's judiciary branch accountable to Governor Tung Chee-hwa.¹⁷⁸ Furthermore, the 1984 Sino-British Joint Declaration requires that the Chief Justice of the Court of Final Appeal to be of Chinese descent, while the other three presiding judges may be of any nationality.¹⁷⁹ Moreover, Hong Kong's Basic Law provides that a judge may be removed for multiple reasons, thereby implying that "judges who want to keep their seats will be under tremendous pressure to find in favor of the Chinese government."¹⁸⁰

The fear of the Beijing government exerting its influence over Hong Kong's judiciary branch grows deeper when it actually threatens the territory's autonomy. This autonomy is impeded by the Basic Law's allocation of jurisdiction to China's NPC concerning "acts of state," which is an exemption to the legal jurisdiction of Hong Kong's judiciary branch that has been left to the discretion of the NPC to interpret.¹⁸¹ Since Hong Kong's passage to Chinese sovereignty, this open-ended question of China's jurisdiction over matters concerning "acts of state" had only been exercised by the NPC one time, in 1999, when the Beijing government asserted its jurisdiction over a Hong Kong immigration issue.¹⁸² In that instance, the NPC had overruled the decision of Hong Kong's Court of Final Appeal, much to the discomfort of many Hong Kong citizens and the international community.¹⁸³

Hong Kong's "rule of law" and judiciary branch are the primary ingredients that distinguish Hong Kong's marketplace from that of China. Every day, investors risk their capital in Hong Kong's marketplace because of the territory's added investor protection, as provided for by its "rule of law," which is interpreted and enforced by its judiciary branch. Hence, any failure on the

177. Basic Law, *supra* note 14, arts. 19, 158, 29 I.L.M. at 1523-24, 1545.

178. *Id.*

179. Basic Law, *supra* note 14, art. 90, 29 I.L.M. at 1534; McDermott, *supra* note 174, at 279.

180. Basic Law, *supra* note 14, art. 89, 29 I.L.M. at 1534; McMurtray, *supra* note 12, at 88.

181. Basic Law, *supra* note 14, art. 19, 29 I.L.M. at 1523-24; McDermott, *supra* note 174, at 276.

182. *Whose Law?*, THE ECONOMIST, Dec. 11, 1999, at 38.

183. *Id.*

part of Hong Kong's judiciary branch to act fairly, equitably, and impartially in its interpretation and enforcement of the territory's laws will only serve to harm the integrity of its stock market. Additionally, any infringement by the Beijing government on the autonomous nature of Hong Kong's judiciary branch will only draw short-term gains for the Chinese economy. In the long run, however, it will serve to induce investors to withdraw their capital from Hong Kong, since reasonable persons will not be willing to invest their life savings in a market that is run by a totalitarian-driven government in which the rule of one party precedes the nation's laws. Thus, it is imperative that China resist the need to exert its influence or control over Hong Kong's judiciary branch so that it may maintain the viability of Hong Kong as a gateway to the world's capital, which is needed to save Beijing's ailing state-run enterprises and economic reforms. Moreover, it is essential to the success of China's "one country, two systems" paradigm that the Beijing government not close the door to future negotiations with neighboring Taiwan concerning a plan of reunification on terms similar to those of Hong Kong.

XII. CONCLUSION

Since the passage of Hong Kong to Chinese sovereignty on July 1, 1997, the Beijing government has complied with its obligations as specified under its Joint Declaration with Britain and Hong Kong's Basic Law. Therefore, Beijing's government has been able to maintain the long-standing integrity of Hong Kong's marketplace and its esteemed status as an international financial center. This has, in turn, allowed it to exploit the venues of Hong Kong's market to raise capital from the international community in order to salvage its ailing state-run economy from dissolution and insolvency by pushing forward with its economic reforms. Moreover, the Beijing government has been able to succeed in the implementation of its government policy of a "one country, two systems" paradigm, as it has retained the territory's "rule of law," market economics and democratic values intact, despite their contravention with the Marxist ideology of China's Communist Party. Hence, the Beijing government should now be able to enter into the negotiation process with neighboring Taiwan with a legitimate plan of reunification, premised on the success of its "one country, two systems" paradigm and its positive handling of Hong Kong's passage to Chinese sovereignty.

The situation in Hong Kong may deteriorate at any time, however, due to the fact that Britain's colonial government was left intact following Hong Kong's passage to Chinese sovereignty.

Hong Kong's laws allocate to Governor Tung Chee-hwa, a political appointee of the Beijing government, a dictatorial authority over the territory's government and economy. This has made Hong Kong's legal system and market structure vulnerable to the political whims of Governor Tung Chee-hwa. Hong Kong's Governor, however, should be reluctant to assert his unhindered authority to intervene in Hong Kong's legal system and market structure, as this behavior would only serve to greatly diminish the integrity of Hong Kong's market, thereby displacing it as an international financial center. Hence, China cannot afford to endure any behavior that jeopardizes the status of Hong Kong's market, because it is their primary gateway for raising capital from the international community. Moreover, the success of China's "one country, two systems" paradigm is dependent upon the continued prosperity of Hong Kong's marketplace, thus, making it essential to the Beijing government's objective of being able to fashion a plan of reunification with neighboring Taiwan on terms similar to those of Hong Kong.

The decision of the Beijing government to extend its "one country, two systems" paradigm beyond its borders to the southern provincial government of Hong Kong, combined with the previously promulgated "open-door" policy of Deng Xiaoping, has let in not only foreign capital, but also Western ideas. Thus, the futility of the Beijing government's policy of building walls between its economic dealings with the Hong Kong market and its political dealings with the Hong Kong government has put in motion a process of modernity that will revolutionize Mainland China's legal system and market structure. In the short term, this process will enable China's Communist Party to retain its control of the government through its ability to continue to finance its failed government and economy through the venues of Hong Kong's marketplace. In the long-run, however, China will become increasingly economically integrated with Hong Kong, which is already demonstrated by the mass migration of China's red chip companies to list on the Hong Kong Stock Exchange, to the point that a political agenda will begin to arise. Eventually, Hong Kong's much stronger legal system and market structure will serve to displace China's Communist Party, thereby giving rise to a new era in Chinese history that is premised on the "rule of law," market economics and democratic values. Then, and only then, will the theory of Mainland China's chief economic city of Shanghai one day replacing Hong Kong as the country's primary financial center be feasible. For now, Shanghai is not deserving of retaining the status of China's primary financial center, due to

Beijing's lack of a credible and reliable legal system to underpin its economy.

