

# Responsibility of Intermediaries from the Case of Zeda and Amethyst

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**Abstract:** The full implementation of the registration system provides more enterprises with listing opportunities, but also brings greater tests to the information disclosure system of the securities market. The change from the approval system to the registration system makes the intermediary assume the role of the gatekeeper of the information disclosure. Under the current attitude of the CSRC, issuers and intermediaries have been punished in an endless stream of news. Under false statements, how to punish the perpetrator and how to make up for the loss of the victim is the focus of the incident handling. The Amethyst Storage case and the Zeda Essence case, as recent typical cases, are also the first cases of fraudulent issuance and settlement of the science and technology board in China. The handling of the responsible personnel in the case and the application of the system of advance compensation and parties' commitment are of great value to the research on the liability of intermediaries.

**Keywords:** Intermediary organization; Misrepresentation; Liability boundary

## 1. Introduction

In 2023, the Issuing Department and Listing Department of the CSRC, together with the Shanghai Stock Exchange and the Shenzhen Stock Exchange, carried out the "Training Meeting for Intermediaries of Comprehensive Registration System", and the meeting mentioned that: strengthening the regulation of information disclosure, increasing the punishment, raising the cost of violation of laws and regulations, and complying with the information disclosure and gatekeeper responsibilities of the issuers. The severity of the penalties imposed by the SEC on the intermediaries in the Amethyst Storage case and the Zeda Essence case, as well as the severity of the accountability of the intermediaries, show the severe situation faced by the intermediaries in the process of public offerings under the full registration system. At the same time, the nature of the misrepresentation case also determines the nature of the case to deal with the settlement process of some special systems, such as the administrative party commitment system, the first pay system, the application of these systems to a large extent to protect the victims of fraudulent issuance, or to make the intermediary institutions from bearing heavier punishment, but also shows the intermediary institutions of the responsibility is very large. The case of Amethyst Storage and Zeda Essence as a sample, we should analyze the intermediaries and the responsibility of the parties, in order to find a better answer to the responsibility

of the intermediaries under the full registration system.

## **2. The Processing of the Two Cases and the Landing of Compensation**

### **2.1 The Case of Amethyst Storage**

#### **2.1.1 Illegal Acts of the Parties and Punishment Decision**

Firstly, Amethyst Storage failed to fulfill the relevant decision-making procedures and information disclosure obligations, and repeatedly violated the rules to provide large guarantees. Secondly, the disclosure of information related to capital restriction is inconsistent, and the information disclosure is untrue and inaccurate.

Based on legal provisions, the CSRC determined that the actual controllers and other organizations and instigations engaged in the above information disclosure violations constitute the illegal acts described in the first and second paragraphs of Article 197 of the Securities Law and make corrections, warnings, fines ranging from 500,000 yuan to 36.6852 million yuan. In addition, the company was also ordered to delist and entered the delisting consolidation period on June 8, 2023, and as of June 30, 2023, the company's shares have been traded for 15 trading days during the delisting consolidation period, and the delisting consolidation period has ended. The listing of the Company's shares was terminated and delisted by the Shanghai Stock Exchange on July 7, 2023.

#### **2.1.2 Application by Intermediaries for Application of the Party Commitment System**

The sponsor agency China Securities Co., Ltd issued a verification opinion that Amethyst Storage does exist in violation of the guarantee situation. On September 3, 2021, the sponsor China Securities Co., Ltd made it clear in the special verification opinion of the "Shanghai Stock Exchange's Information Disclosure Regulatory Inquiry Letter for Amethyst Storage's semi-annual Report 2021" that at the end of June 2021, the company's monetary funds, in addition to the deposit used for issuing bank acceptance bills, were restricted funds. The rest of the funds do not exist due to pledge, guarantee and other circumstances resulting in limited funds. As the sponsor of Amethyst storage, the inconsistent answers of China Securities Co., Ltd are neither rigorous nor professional.

The CSRC has launched relevant investigations on China Securities Co., Ltd, Rongcheng Accounting Firm, Zhitong Accounting Firm, Guangdong Hengyi Law Firm and other intermediary institutions, and will deal with them according to law according to their diligence and responsibility in relevant practices, combined with their initiative to pay compensation in advance and apply for party commitment in securities and futures administrative law enforcement.

On May 27, 2023, China Securities Co., Ltd and Investment announced that the company, together with the accounting firm, Rongcheng Accounting Firm, and Guangdong Hengyi Law Firm formally established a special fund for the compensation of Amethyst event, with a total of 1 billion yuan. It is used to compensate investors for investment losses caused by the fraudulent issuance of amethyst storage and illegal information disclosure.

In addition, four intermediaries applied to the CSRC for the application of the Commitment system

for parties involved in securities and futures administrative enforcement, which was accepted by the CSRC in accordance with the law.

## 2.2 Handling of Zeda Essence Case

### 2.2.1 Illegal Acts of the Parties

Zeda Essence conceals important facts and fabricates material false content in the securities, and there are false records and major omissions in the disclosed 2020 Annual Report and 2021 Annual Report.

### 2.2.2 Settled Through Mediation

On December 26, 2023, the SFC heard the investor v. Zeda and 12 defendants such as the actual controller, executives, intermediaries and other securities misrepresentation liability dispute was concluded by mediation. China Securities Small and Medium Investors Service Center, on behalf of 7,195 eligible investors received 280 million yuan in full compensation, covering 99.6% of the investors, of which a single investor received a maximum compensation of more than 5 million yuan, and the average person received a compensation of 38,900 yuan. Among them, Zeda Co., the actual controller Lin Ying, directly responsible for the supervisor should LAN bear the main liability for compensation. Other directly responsible persons of Zeda, intermediaries of securities issuance and their directly responsible persons shall be held responsible according to their respective degree of fault.

## 3. Application of Special Systems in Case Handling

### 3.1 Advance Compensation System

In recent years, China's capital market has carried out a series of practical explorations in the exercise of rights protection of small and medium-sized investors, and built up the First Compensation, Dispute Mediation, Ordinary Representative Litigation, Investor Protection Agency Representative Litigation and so on. Securities misrepresentation cases has a significant effect on investor compensation. According to the completed advance compensation cases, the indemnated investors account for more than 95% and the compensation amount accounts for more than 98%, and the claim time is greatly shortened and the claim efficiency is improved compared with litigation. Through the pre-payment system, investors can obtain compensation in a shorter period of time, avoiding lengthy litigation procedures.

Considering that the issuer's Amethyst storage and related personnel have limited compensation capacity, it may face difficult implementation through civil litigation. If investors obtain compensation through the way of advance compensation, it undoubtedly reduces the litigation costs of investors, increases the certainty and compresses the compensation time.

### 3.2 Commitment System for Parties Involved in Securities and Futures Administrative Enforcement

Commitment System for Parties Involved in Securities and Futures Administrative Enforcement, also

known as securities administrative settlement, refers to the securities regulatory agencies on suspected securities and futures violations of the unit or individual investigation, the party under investigation commitment to correct the suspected illegal behavior, compensation for the loss of the investors concerned, to eliminate the damage or adverse impact of the securities regulatory agencies recognized by the securities regulatory agencies, the party to fulfill the commitment of the securities regulatory agencies to terminate the case investigation of administrative law enforcement methods. The establishment of a party commitment system for administrative enforcement in the field of securities and futures, which introduces the contractual negotiation in the field of private law into the field of public power, is a major innovative step in the reform of the administrative enforcement system of the Securities and Futures Commission, reflecting the transformation of securities supervision from mandatory law enforcement to service-oriented law enforcement, and actively exploring a more diversified, flexible and rigid mode of governance.

### 3.2.1 Definition of the Amount of Commitment

According to Article 14 of the Measures for the Implementation of the Enforcement, the determination of the amount of the commitment fee shall comprehensively consider the amount of the party suspected of illegal acts that may be fined and the amount of illegal income confiscated. The loss suffered by the investor due to the suspected illegal acts of the parties and the law enforcement stage of the case at the time of signing the acceptance agreement.

In the case, the total commitment of the four intermediaries is 1,274,523,752 yuan, of which 1,085,585,416 yuan has been paid to investors through the early compensation procedure.

### 3.2.2 The Applicable Value of the Parties' Commitment System

Firstly, the interests of investors are protected to the maximum extent and with the highest efficiency. This case is dealt with by the combination of the commitment of the parties to the administrative law enforcement and the compensation in advance. According to the calculation of the insurance fund company, there were 17,471 damaged investors in this case, with a total loss of more than 1.097 billion yuan, and 16,986 investors received 1.086 billion yuan compensation in just two months, accounting for 97.22% of the total number of damaged people and 98.93% of the total amount of compensation.

Secondly, the parties suspected of violating the law were severely punished. In addition to the economic cost of about 1.275 billion yuan, the parties involved in the case also need to conduct self-inspection and rectification in accordance with the requirements of the China Securities Regulatory Commission, seriously investigate the responsibility of the responsible person and take internal disciplinary measures, strengthen the compliance risk control and management ability, and effectively improve the quality of practice. Among them, the relevant responsible personnel are not only subject to high fines, withholding and recovery of bonuses, dismissal, may not issue reports within a certain period of time and other internal disciplinary measures taken by their respective institutions, and the CSRC will take administrative regulatory measures according to the circumstances. The responsibility of the intermediary "gatekeeper" has been consolidated, and violations of laws and regulations have been

severely punished.

Thirdly, the effective combination of administrative law enforcement and civil compensation has been realized to improve the efficiency of law enforcement. Through the use of the comprehensive law enforcement method of the commitment of the parties to administrative law enforcement, on the one hand, the relevant law enforcement cases are quickly solved, the case is timely concluded, and the law enforcement efficiency is improved. On the other hand, the losses of investors are quickly compensated, the relevant civil disputes are timely resolved at the front end, the source of litigation is well managed, and the follow-up judicial resources are saved. It realizes the unification of administrative law enforcement and civil compensation, the unification of legal effect and social effect.

In addition, the application of the party commitment system in the amethyst storage case has restored market order in a timely manner and stabilized market expectations. Through disciplinary warnings for illegal actors and efficient compensation for investors, the market order is effectively maintained, the market environment is purified, and market expectations and confidence are stabilized.

### 3.3 The First Mediation of the Special Representative's Lawsuit Concludes the Case

The case of Zeda Essence is the second case of special representative litigation in China after the case of Kangmei Pharmaceutical case. The existence of the special representative litigation mechanism provides a strong support for the strengthening of post-event supervision under the framework of the registration system, effectively deterring illegal market behaviors, and escorting the comprehensive registration system. The purpose is to select “typical significant, bad social impact, with exemplary significance” cases, by the investor protection agency as the representative of the special representative litigation, while protecting the interests of investors, the subject of making false statements to severely punish, so as to deter potential offenders. For this reason, investor protection agencies should bring special representative lawsuits with a certain degree of continuity, in order to create psychological deterrence to potential offenders.

## **4. the deepening and boundary of the responsibility of intermediary institutions from the two cases**

Intermediaries participate in the information disclosure process of securities issuance, and information disclosure is the front-end item and pre-work in the overall process of securities issuance. Under the registration system of false statements, intermediaries should “promote the front end from the back end, and promote the front end from the event.” In fact, in the context of the comprehensive registration system, regulators are constantly strengthening the supervision of intermediaries to improve the quality of business practice, and continue to consolidate the “gatekeeper” responsibility of intermediaries. In this regard, China Securities Co., Ltd in charge of investment banking business said in an interview, the company has done a deep introspection and serious rectification of the Amethyst storage project, to be paid through the first way to take the initiative to compensate for the losses of investors, to eliminate the related adverse impact, while continuing to improve the "three lines of defense", improve the whole process of quality control system, the establishment of a comprehensive risk management and compliance management system, and continue to improve the quality of practice, and effectively take up the capital market, "the gatekeeper" responsibility.

## 4.1 Evolution of the Role of Intermediaries under Different Issuance Review Systems

### 4.1.1 the Marginal Status of Intermediary Institutions under the Approval System

As the earliest issuance audit system in China, the approval system is a continuation of the high government color of the state-owned financial system in the capital market at that time, which was applied in the initial stage of China's capital market because of its adaptation to the environment at that time, and later it has been eliminated because of the market environment.

Under the approval system, the issuance of securities is completely arranged by the government, and the government arranges the quota, standards and conditions of securities issuance, and information disclosure is not a condition of securities issuance. Under the examination and approval system, the task of the intermediary is to help the issuer to make stock declaration. Because the key role of the intermediary is to check the information disclosure content, the role of the intermediary is very marginal under the examination and approval system.

### 4.1.2 The “IPO gatekeeper” under the Approval System Has Taken Shape

If the approval system is that the government handles the issuance of securities all by itself, then the government departments under the approval system have become parents who are willing to let go of their hands to a certain extent.

Under the approval system, the government department has the leading power of securities issuance, the substantive examination power and the final approval power, and at the same time, it reduces the workload of the government department under the approval system by strengthening the information disclosure. The government will take the initiative to make a substantive review and judgment on the issuer, which is based on the information disclosed by the issuer under the supervision of the intermediary agency. The compliance of information disclosure and the content of disclosure become the audit object of the audit authority. Due to the supervisory function of intermediaries in the process of information disclosure, the quality and efficiency of securities issuance under the approval system are better than those under the approval system. Under the approval system, the role positioning of intermediary agencies as “IPO gatekeeper” has begun to take shape, but under the approval system, the administrative leadership of government departments is still in an absolute position, and the intermediary agencies only assume the role of auxiliary.

### 4.1.3 the Depth of the Establishment of “IPO gatekeeper” under the Registration System

The driving force of the reform of the registration system is to return the choice to the market, strengthen the market constraints and the rule of law constraints. Instead of having the government, the parent, make the choices ahead of time for the market. The core of the registration system is information disclosure. Compared with the information disclosure system under the approval system, the information disclosure under the registration system is more central and dominant. It can be said that the legal regulation under the registration system is a series of institutional arrangements with information disclosure as the core. The core status of information disclosure also means that the

participation of intermediaries has been greatly enhanced. Its responsibility is an important part of the responsibility system under the registration system.

Under the registration system, the issuance of securities has become a formal review, and the government organs no longer conduct strict substantive review on the quality of securities, but the object of formal review is the issuer's information issued by intermediaries. As the main body of securities issuance, the issuer bears the primary responsibility for all kinds of problems that occur in the issuance process. The intermediary, as an auxiliary to the issuer and an intermediary organization with regulatory functions, plays a role in the process of securities information disclosure. Under the registration system, the intermediary has completed the profound establishment of its role, which is a well-deserved "IPO gatekeeper".

#### 4.2 The Responsibility of An Intermediary Institution Is Reasonably Assumed

In essence, the intervention of intermediaries is to "increase credit" for issuers to issue credit, and through their professional activities, they help issuers reduce the investigation costs and transaction costs of investors on issuers' principal credit. The mechanism of post-hoc accountability for intermediary institutions should also be determined by the actual function and positioning of intermediary institutions in the market. The return of intermediary institutions is an important basis for the smooth implementation of the registration system, and is also an important entry point and focus for the high-quality development of the capital market.

##### 4.2.1 Clear Responsibility Content and Details

In this context, it is particularly important to vigorously promote the high-quality development of intermediary institutions. The high-quality development of securities management institutions must achieve clear strategy, accurate positioning, strong professional strength, effective management and control, sustainable development and excellent culture. Strengthening the construction of the rule of law and tightening the responsibility of intermediary institutions is a major focus of registration system reform. At present, the legal constraints on intermediary institutions have been basically complete. In practice, there are still many details to be clarified in scientific allocation of intermediary responsibility.

From the history of global securities trading, the initial securities trading actually has no intermediary underwriting, sponsorship, audit or lawyer verification and other professional services, which brings the problem that the credit cost of transactions between market entities is too high, affecting the formation of the best game transaction price. In essence, the intervention of intermediaries is to "increase credit" for issuers to issue credit, and through their professional activities, they help issuers reduce the investigation costs and transaction costs of investors on issuers' principal credit. The mechanism of post-hoc accountability for intermediary institutions should also be determined by the actual function and positioning of intermediary institutions in the market. The key to clarify the responsibility of intermediary institutions is to distinguish the "special duty of care" and "general duty of care" that intermediary institutions should bear. In terms of how to determine accurately, the judicial interpretation stipulates that each intermediary agency should bear the special duty of care in its own professional field, and the general duty of care is not in the professional field. However, in practice,

which is the duty of special care, which is the duty of general care, very test the wisdom of judicial practice. At present, a very important issue is to clarify accounting responsibility and audit responsibility. In practice, the most common intermediaries - securities firms, law firms and clubs - may be the most bitter, and a prominent problem is that accounting responsibility and audit responsibility have yet to be clarified. The quality of intermediary professional services is related to the quality of listed companies and securities, and then to the interests of investors. Too light responsibility will encourage the violation of law, too heavy responsibility will make the intermediary institutions overwhelmed, only clear how to identify the responsibility of intermediary institutions can balance the protection of investors and the long-term development of intermediary institutions.

#### 4.2.2 Clarify “expert obligations” and “non-expert obligations”

As for the fault determination of intermediaries, Article 11 of the Securities Act of 1933 stipulates that non-professionals shall rely on the truth of relevant statements after “reasonable investigation” for the content without professional opinion support and the professional opinions issued by professionals themselves; A lay person does not need to make a “reasonable investigation” into a professional opinion or official document issued by a professional, only to prove that there are no reasonable grounds to believe and do not believe that there is a misrepresentation or omission; A professional shall not be liable for any misrepresentation other than that of his professional opinion. China's Judicial Interpretation of False Statements, recent regulatory rules and judicial precedents all show a tendency to distinguish expert liability from non-expert liability. However, in practice, how to identify the identity of underwriters and sponsors, and how to judge the reasonable trust standard of intermediary institutions for professional opinions of other intermediaries remains to be explored.

#### 4.2.3 Clarify the Boundaries of Responsibilities Between Intermediaries

When determining the responsibility of intermediaries, we should also pay attention to the differences in their duties and obligations under different identities. Taking securities companies as a typical representative, according to relevant regulations, the continuous supervision obligations of securities companies as sponsors and financial advisers are obviously different from their responsibilities in the issuance and restructuring stages. In the stage of issuance and reorganization, sponsors and financial advisers have the obligation to check and verify the information of listed companies, while in the stage of continuous supervision, sponsors and financial advisers only have the obligation to review the general information disclosure of listed companies in time, but do not have the obligation to prudently check or guarantee the truth, accuracy and completeness. In the bond misrepresentation dispute, there have been cases in which the bond trustee is listed as a co-defendant and requires the liability for misrepresentation. The bond trustee is neither a bond underwriter nor a bond service institution, and its focus is to perform its duties fairly and safeguard the rights and interests of the holders, and it has no obligation to prudently check the information disclosure documents of the issuer during the duration of the bond. The trustee management report usually makes clear statements and hints that the quoted content is not verified. It is expected that judicial cases will clearly define the identity and responsibilities of the bond trustee and provide useful guidance for the orderly



development of the bond market.

## **5. Conclusion**

The change from the approval system to the registration system makes the intermediary assume the role of the gatekeeper. Under the current attitude of the CSRC, the intermediary institutions should actively implement self-management, ensure that they perform their duties in the process of securities listing audit. And they should actively settle the claim that loss of the investor group. Give full play to the advantages of the system of advance compensation and commitment of the parties to solve the problem. The implementation of advance compensation by intermediaries, has reduced the litigation costs of investors, increased the certainty, compressed the compensation time, and largely eliminated the adverse effects of the malignant events of false statements. But on the other hand, the responsibility boundary between the four intermediaries is still not very clear. If it needs to be further clarified, it still needs to be further discussed from the performance content of the intermediary, fault or not, and expert obligations, which is also an important part of the identification of the responsibility of the intermediary agencies in other cases.

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