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# LEGAL ASPECTS OF THE COMMODITY AND FINANCIAL FUTURES MARKET IN CHINA

*Sanzhu Zhu* \*

## I. INTRODUCTION

The establishment of China's first commodity futures exchange in Zhengzhou, Henan in October 1990 marked the emergence of a futures market in China. The Zhengzhou Commodity Exchange was created in the wake of the country's economic reform and development, and it became the first experimental commodity futures market approved by the central government. The Zhengzhou Commodity Exchange provided a platform and facilitated a need for commodity futures trading arising alongside China's economic reform, which had begun in 1978, and which was moving towards a market economy by the early 1990s.<sup>1</sup> Sixteen years later, the China Financial Futures Exchange (CFFEX) was established in Shanghai.<sup>2</sup> This was followed by the opening of gold futures trading on the Shanghai Futures Exchange on January 9, 2008.<sup>3</sup>

China gradually developed a legal and regulatory framework for its commodity and financial futures markets beginning in the early 1990s,

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1. Prior to the introduction of futures trading on May 28, 1993, the Zhengzhou Commodity Exchange operated for two years dealing with trading of cash forward contracts. Currently the futures products traded on the Zhengzhou Commodity Exchange include wheat, cotton, white sugar, pure terephthalic acid (PTA), rapeseed oil and green bean futures contracts. See Zhengzhou Commodity Exchange Homepage, <http://www.czce.com.cn> (follow "About the Exchange" ("Guan yu Jiao Yi Suo") hyperlink) (last visited Feb. 23, 2009).

2. Approved by the State Council and the China Securities Regulatory Commission (CSRC), China Financial Futures Exchange (CFFEX) was established jointly by the five current securities and futures exchanges, namely, the Shanghai Futures Exchange, Zhengzhou Commodity Exchange, Dalian Commodity Exchange, Shanghai Stock Exchange and Shenzhen Stock Exchange. The CSI 300 index futures contract is a product that CFFEX prepares to launch. Underlying the CSI 300 index futures contract is the CSI 300 index, (*hushen 300 zhishu*), which comprises 300 A-shares listed on Shanghai Stock Exchange and Shenzhen Stock Exchange and represents 60% market capitalization of Shanghai and Shenzhen markets as a whole. For more information about the CSI 300 index, see China Securities Index Co., Ltd Home Page, [www.csindex.com.cn](http://www.csindex.com.cn) (follow "List of Indexes" ("Zhi Shu Xi Lie") hyperlink) (last visited Feb. 20, 2009). Apart from the CSI 300 index futures contract, CFFEX plans to introduce in the future other index futures, index options, government bonds futures and currency futures. See China Financial Futures Exchange Home Page, <http://www.cffex.com.cn> (follow "About the Exchange" ("Guan yu Jiao Yi Suo") hyperlink) (last visited Feb. 20, 2009).

3. The launch of gold futures trading was met by enthusiastic investors. See Javier Blas & Chris Flood, *Gold Futures Flies High in Shanghai Market*, FIN. TIMES, Jan. 9, 2008, available at [http://us.ft.com/ftgateway/superpage.ft?news\\_id=fto010920081600301332&page=2](http://us.ft.com/ftgateway/superpage.ft?news_id=fto010920081600301332&page=2).

when the first government futures regulatory documents were issued,<sup>4</sup> and continuing into early 2007, when the 2007 Regulations on the Administration of Futures Trading (2007 Regulations) replaced the 1999 Provisional Regulations on the Administration of Futures Trading (1999 Provisional Regulations).<sup>5</sup> At a practical level, detailed trading rules were enacted for each of the futures exchanges,<sup>6</sup> while rules and procedural guidelines were developed in judicial and non-judicial resolution of disputes arising from futures trading.<sup>7</sup> Those rules and guidelines played an integral part in shaping the development of futures trading in China.

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4. See, e.g., Guowuyuan guan yu jian jue zhi zhi qi huo shi chang mang mu fa zhan de tong zhi [Notice of the St. Council on Firmly Stopping Blind Dev. of the Futures Mkt.] (promulgated by the St. Council, Nov. 14, 1993, effective Nov. 14, 1993), available at [http://law.baidu.com/pages/chinalawinfo/1/2/ce4e878e724d70b042645b67d39ef581\\_0.html](http://law.baidu.com/pages/chinalawinfo/1/2/ce4e878e724d70b042645b67d39ef581_0.html) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter The Notice of the St. Council on Firmly Stopping Blind Dev. of the Futures Mkt.]; see also Qi huo jing ji gong si deng ji guan li zhan xing ban fa [Provisional Measures on the Admin. of Registration of Futures Broker Firms] (promulgated by the St. Admin. for Indus. & Commerce, Apr. 28, 1993, effective Apr. 28, 1993) (repealed 1998 & 2004), available at [http://law.baidu.com/pages/chinalawinfo/0/62/81cf6b445492920d18772174cfl53c36\\_0.html](http://law.baidu.com/pages/chinalawinfo/0/62/81cf6b445492920d18772174cfl53c36_0.html) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter The Provisional Measures on the Admin. of Registration of Futures Broker Firms]; Guowuyuan ban gong ting zhuan fa Guowuyuan zheng quan wei yuan hui guan yu jian jue zhi zhi qi huo shi chang mang mu fa zhan ruo gan yi jian qing shi de tong zhi [Notice of the Gen. Office of the St. Council Relaying the Request of the St. Council Sec. Comm. Seeking Instructions on Several Opinions on Firmly Stopping Blind Dev. of the Futures Mkt.] (promulgated by the Gen. Office of the St. Council, May 16, 1994, effective May 16, 1994), available at <http://www.haaic.gov.cn/info.asp?classkey=1002&id=997> (last visited Apr. 24, 2009) (P.R.C.) [hereinafter The Notice of the Gen. Office of the St. Council Seeking Instructions on Several Opinions on Firmly Stopping Blind Dev. of the Futures Mkt.].

5. See Qi huo jiao yi guan li tiao li [Regulations on the Admin. of Futures Trading] (promulgated by the St. Council, Mar. 6, 2007, effective Apr. 15, 2007, St. Council Order No. 489), available at [http://www.gov.cn/zwqk/2007-03/16/content\\_553002.htm](http://www.gov.cn/zwqk/2007-03/16/content_553002.htm) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter The 2007 Regulations on the Admin. of Futures Trading].

6. The Zhengzhou Commodity Exchange, Shanghai Futures Exchange, Dalian Commodity Exchange and China Financial Futures Exchange have all listed their trading rules on their websites, covering every aspect of futures trading in their respective market. See Zhengzhou Commodity Exchange Home Page, [www.czce.com.cn](http://www.czce.com.cn) (follow “Exchange Regulations” (“Ye Wu Gui Ze”) hyperlink) (last visited Mar. 4, 2009); Shanghai Futures Exchange Home Page, <http://www.shfe.com.cn> (follow “Rules & Regulations” (“Fa Lü Fa Gui”) hyperlink) (last visited Mar. 4, 2009); Dalian Commodity Exchange Home Page, <http://www.dce.com.cn> (follow “Futures Regulations” (“Qi Huo Fa Gui”) hyperlink) (last visited Mar. 4, 2009); China Financial Futures Exchange Home Page, <http://www.cffex.com.cn> (follow “Rules & Regulations” (“Fa Lü Fa Gui”) hyperlink) (last visited Mar. 4, 2009).

7. See, e.g., Zui gao ren min fa yuan yin fa guan yu shen li qi huo jiu fen an jian zuo tan hui ji yao de tong zhi [The Notice of the Supreme People’s Court on Circulating ‘Minutes of the Symposium of the Supreme People’s Court on Adjudication of Cases of Futures Disputes’] (promulgated by the Supreme People’s Court, Oct. 27, 1995), translated in ISINOLAW (last visited Apr. 24, 2009) (P.R.C.) [hereinafter The 1995 SPC Futures Judicial Guidelines]; Zui gao ren min fa yuan guan yu shen li qi huo jiu fen an jian ruo gan wen ti de gui ding [Provisions of the Supreme People’s Court on Several Issues Concerning Adjudication of Cases of Futures Disputes] (adopted by the Adjudication Comm. of the Supreme People’s Court May 16, 2003, effective July 1, 2003), available at <http://www.court.gov.cn/lawdata/explain/civil/200306270003.htm> (last visited Mar. 20, 2009) (P.R.C.) [hereinafter The 2003 SPC Futures Judicial Provisions]; Shanghai qi huo jiao yi jiu fen chu li yan tao hui ji yao [The Summary of Shanghai Seminars on Handling

To a large extent, the patterns of, and relationships between, the development of the legal, regulatory and judicial framework and procedures in China's commodity and financial futures market are no different from the patterns and relationships found in other areas of Chinese commercial law and regulations. That is, legislation begins as tentative, ad-hoc or local regulations, which pave the way to formal national regulation,<sup>8</sup> which is then further supplemented by detailed implementing rules from central government regulators.<sup>9</sup> Ultimately, national law is enacted by the National People's Congress or its Standing Committee, China's law-making body.<sup>10</sup> On the judicial side, the Supreme People's Court formulates jurisdiction-specific procedural principles and guidelines for dispute resolution in accordance with the 1991 Civil Procedure Law (as amended in 2007),<sup>11</sup>

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*Futures Trading Disputes*] in *Qi huo jiao yi jiu fen an li ping xi* [COMMENTARY AND ANALYSIS ON FUTURES TRADING DISPUTE CASES] (Zhong Futang et al. eds., Shanghai: Xuelin Publishing House, 1998) [hereinafter *The Summary of Shanghai Seminars on Handling Futures Trading Disputes*].

8. For example, in the area of company law, before the enactment of the Company Law of the People's Republic of China by the Standing Committee of the National People's Congress in December 1993 (as amended in 1999, 2004 & 2005), there were a range of regulations, regulatory documents and implementing rules at both local and national level. See *Fu jian Fu jian tou zi qi ye gong si zhai quan fa xing ban fa* [Measures of Fujian Province for Issuance of Bonds by Fujian Investment Enters. Co.] (promulgated by the Fujian Gov't Jan. 17, 1980, effective Jan. 17, 1980) (repealed July 28, 2000), available at <http://www.bht.yn.gov.cn/Article/1980/19800117000000.html> (P.R.C.); *Guo wu yuan guan yu jin yi bu qing li he zheng dun gong si de tong zhi* [Notice of the State Council on Further Clear-up & Consolidation of Cos.] (promulgated by the St. Council Aug. 20, 1985, effective Aug. 20, 1985), available at <http://www.yfzs.gov.cn/gb/info/LawData/gjf2001q/gwyfg/2003-06/24/1558598998.html> (P.R.C.); *Guang dong sheng jing ji te qu she wai gong si tiao li* [Regulations of Guangdong Province on Foreign Related Cos. in Special Econ. Zones] (adopted by the Standing Comm. of Guangdong Provincial Sixth People's Cong. Sept. 28, 1986, promulgated Oct. 20, 1986, effective Jan. 1, 1987), available at <http://www.law-lib.com/lawhtm/1986/47762.htm> (P.R.C.); *Xia men shi zu jian gu fen you xian gong si shi dian ban fa* [Trial Measures of Xiamen City for Establishment of Co. Limited by Shares] (promulgated by the Xiamen Gov't July 24, 1991, effective July 24, 1991), available at <http://bht.yn.gov.cn/Article/1991/19910724000000.html> (P.R.C.); *Shanghai shi gu fen you xian gong si zan xing gui ding* [Tentative Regulations of Shanghai City on Company Limited by Shares] (promulgated by the Shanghai City Gov't May 18, 1992, effective June 1, 1992), available at [http://www.pt.fjaic.gov.cn/law\\_show.asp?law\\_type=DSHS1024](http://www.pt.fjaic.gov.cn/law_show.asp?law_type=DSHS1024) (P.R.C.); *You xian ze ren gong si gui fan yi jian* [Opinions on Standardization of Ltd. Liability Co.] (promulgated by the St. Commission for Econ. System Reform May 15, 1992, effective May 15, 1992), translated in ISINOLAW (last visited Apr. 24, 2009) (P.R.C.); *Gu fen you xian gong si gui fan yi jian* [Opinions on Standardization of Co. Limited by Shares] (promulgated by the St. Commission for Econ. System Reform May 15, 1992, effective May 15, 1992), translated in ISINOLAW (last visited Apr. 24, 2009) (P.R.C.).

9. See sources cited *supra* note 8.

10. *Id.*

11. See *Zhong hua ren min gong he guo min shi su song fa* [Civil Procedure Law] (promulgated by the 7th National People's Congress on Apr. 9, 1991, effective Apr. 9, 1991, revised Oct. 28, 2007, effective Apr. 1, 2008), available at <http://www.court.gov.cn/lawdata/law/civilization/200807310024.htm> (P.R.C.) [hereinafter 1991 Civil Procedure Law].

primary and general legislations such as the 1986 General Principles of Civil Law (1986 GPCL),<sup>12</sup> and special laws and regulations of that area.<sup>13</sup>

This article will first examine the emergence and development of China's futures market and the corresponding development of regulatory and judicial rules, and then focus on several legal aspects of futures trading, including the regulation of broker entry into the futures trading market, the responsibilities of futures exchanges in overseeing futures trading, and further aspects of the financial futures market. Historically, these issues generated a relatively high rate of disputes, particularly during the 1990s. Discussions therefore include an examination of the range of people's court cases adjudicating legal principles, administrative regulations and judicial procedural rules as applied and as evolved in past years. In considering the emergence and development of China's commodity and financial futures market in the past decades, this article examines how the country's commodity and financial futures market developed through a tortuous passage, and further submits that an appropriate and balanced legal, regulatory and judicial framework is crucial to ensure the healthy and sustainable development of the commodity and financial futures market in China.

Part II tracks the early development of the legal and regulatory framework for the commodity and financial futures market in China. Part III recounts the development of principles and procedures for dispute resolution surrounding futures trading, by examining the dispute resolution procedures developed by the Supreme People's Court, securities professional associations and government securities regulators. Part IV defines futures contracts under Chinese securities law and regulation, and Part V introduces the procedures and requirements for engaging in futures trading. Part VI elaborates on futures trading as carried out by futures broker firms on their clients' instructions and related transactional issues. Next, Part VII sets forth issues surrounding forced liquidation by a futures

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12. Min fa tong ze [General Principles of Civil Law] (promulgated by the Nat'l People's Cong., Apr. 12, 1986, effective January 1, 1987), available at <http://www.court.gov.cn/lawdata/law/civil/200807310022.htm> (last visited Mar. 20, 2009) (P.R.C.) [hereinafter 1986 GPCL].

13. See, e.g., Zui gao ren min fa yuan guan yu shen li piao ju jiu fen an jian ruo gan wenti de gui ding [Several Provisions of the Supreme People's Court on Hearing Disputes Involving Negotiable Instruments] (promulgated Nov. 14, 2000, effective Nov. 21, 2000), available at [http://www.law-lib.com/law/law\\_view.asp?id=528](http://www.law-lib.com/law/law_view.asp?id=528) (last visited Apr. 24, 2009) (P.R.C.); Zui gao ren min fa yuan guan yu shen li zheng quan shi chang yin xu jia cheng shu yin fa de min shi pei chang an jian de ruo gan gui ding [Several Provisions of the Supreme People's Court on Hearing Civil Compensation Cases Arising From False Statements on the Sec. Mkt.] (promulgated Jan. 9, 2003, effective Feb. 1, 2003), available at [http://www.law-lib.com/law/law\\_view.asp?id=42438](http://www.law-lib.com/law/law_view.asp?id=42438) (last visited Apr. 24, 2009) (P.R.C.); Zui gao ren min fa yuan guan yu shen li she ji guo you tu di shi yong quan he tong jiu fen an jian shi yong fa lu wen ti de jie shi [Interpretations of the Supreme People's Court on Application of Law in Hearing Disputes on Contracts Involving State-Owned Land Use Rights] (promulgated June 18, 2005, effective Aug. 1, 2005), available at <http://rmfyb.chinacourt.org/public/detail.php?id=84406> (last visited Apr. 24, 2009) (P.R.C.).

exchange or futures broker firm. Part VIII examines the responsibilities of futures exchanges in overseeing futures trading. Part IX then compares the development of the financial futures market to the commodity futures market in China. Finally, Part X concludes that an appropriate and balanced legal, regulatory and judicial framework is crucial to ensure the healthy and sustainable development of the commodity and financial futures market in China.

## II. THE DEVELOPMENT OF REGULATION OF THE FUTURES MARKET IN CHINA

The early 1990s witnessed the rapid establishment of futures exchanges in China. At the height of the expansion, fifty futures exchanges were established in major cities throughout the country.<sup>14</sup> In 1993, such blind expansion led to problems with excessive speculative trading and various illegal activities, which prompted the government to impose tight control over the rapid growth and ensuing activities of the futures market.<sup>15</sup> A consolidation process substantially reduced the number of futures exchanges to fourteen by the middle of the 1990s.<sup>16</sup> This consolidation process continued into the late 1990s, whereby the remaining fourteen futures exchanges were further consolidated to the three now-existing exchanges:<sup>17</sup> the Zhengzhou Commodity Exchange, the Shanghai Futures Exchange,<sup>18</sup> and the Dalian Commodity Exchange.<sup>19</sup> Alongside the

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14. See *Qi huo jiao yi min shi ze ren* [CIVIL LIABILITIES OF FUTURES TRADING] Preface, 1 (Wu Qingbao & Jiang Xiangyang eds., China Legal System Publishing House 2003) (in looking briefly at the history of China's futures market, the author said that the futures market "experienced a period of blind expansion during the early stage of trial . . .") [hereinafter CIVIL LIABILITIES OF FUTURES TRADING].

15. On November 14, 1993, the State Council issued the Notice of the State Council on Firmly Stopping Blind Development of the Futures Market (*Guo wu yuan guan yu jian jue zhi zhi qi huo shi chang mang mu fa zhan de tong zhi*), which stated, among other things, that "[t]he futures market . . . has high risk and speculation. . . . Based on the actual circumstances of our country at its current stage, futures markets must be strictly controlled and cannot develop blindly, except for a select few commodities and locations for trial experimentation." See The Notice of the St. Council on Firmly Stopping Blind Dev. of the Futures Mkt., *supra* note 4.

16. See CIVIL LIABILITIES OF FUTURES TRADING *supra* note 14, at Preface, 1.

17. The Notice of the State Council on Further Consolidation & Standardization of the Futures Market issued on August 1, 1998 set out, among other things, a plan for the consolidation of the existing fourteen futures exchanges into three by merging or restructuring them. For example, the Notice required that Shanghai Commodity Exchange, Shanghai Metal Exchange and Shanghai Grain & Oil Exchange be merged into one as Shanghai Futures Exchange. See *Guowuyuan guan yu jin yi bu zheng dun he guifan qi huo shi chang de tong zhi* [The Notice of the St. Council on Further Consolidation & Standardization of the Futures Mkt.] (promulgated by the St. Council, Aug. 1, 1998, effective Aug. 1, 1998), available at [http://law.baidu.com/pages/chinalawinfo/2/10/b710b4653690843ae08d472ff275dbfa\\_0.html](http://law.baidu.com/pages/chinalawinfo/2/10/b710b4653690843ae08d472ff275dbfa_0.html) (last visited Mar. 30, 2009) (P.R.C.).

18. The Shanghai Futures Exchange was established in 1998 by merging the Shanghai Commodity Exchange, Shanghai Metal Exchange, and Shanghai Grain & Oil Exchange and business started in December 1999. Futures products currently include copper, aluminium, natural rubber, fuel oil, zinc and gold futures contracts. See Shanghai Futures Exchange Home Page,

expansion of the futures market, over one thousand futures trading firms were founded, although this number has subsequently reduced to less than two hundred.<sup>20</sup>

Between 1993 and 1998, central and local governments issued various regulations, including the Provisional Measures on the Administration of Registration of Futures Broker Firms,<sup>21</sup> the Notice of the State Council on Firmly Stopping Blind Development of the Futures Market,<sup>22</sup> the Opinion of the General Office of the State Council Securities Committee on Firmly Stopping Blind Development of the Futures Market,<sup>23</sup> the Provisional Measures on the Administration of Personnel Working in Futures Business Organizations,<sup>24</sup> the Regulations on the Administration of Shanghai Futures Market,<sup>25</sup> and the Notice of the State Council on Further Consolidation and Standardization of the Futures Market.<sup>26</sup> The central purpose of those government documents was to develop a futures market in China with great caution: on one hand, the futures market was allowed to continue to exist and develop, but on the other hand, its continued existence and development was tightly controlled and regulated.<sup>27</sup> For instance, some commodity futures contracts were removed from the product list of

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<http://www.shfe.com.cn> (follow “About the Futures Exchange” (“Guan Yu Qi Jiao Suo”) hyperlink) (last visited Mar. 4, 2009).

19. The Dalian Commodity Exchange, located in Dalian, Liaoning, was established on February 28, 1993. Futures products currently include corn, soybeans No.1 and No.2, soybean meal, soybean oil, linear low density polyethylene (LLDPE) and RBD palm oil futures contracts. See Dalian Commodity Exchange Home Page, <http://www.dce.com.cn> (follow “About the Exchange” (“Guan Yu Jiao Yi Suo”) hyperlink) (last visited Mar. 4, 2009).

20. See CIVIL LIABILITIES OF FUTURES TRADING, *supra* note 14, at Preface, 1.

21. See The Provisional Measures on the Admin. of Registration of Futures Broker Firms, *supra* note 4.

22. See The Notice of the St. Council on Firmly Stopping Blind Dev. of the Futures Mkt., *supra* note 4.

23. See The Notice of the Gen. Office of the St. Council Seeking Instructions on Several Opinions on Firmly Stopping Blind Dev. of the Futures Mkt., *supra* note 4.

24. Qi huo jing ying ji gou gong ye ren yuan guan li zhan xing ban fa [Provisional Measures on the Admin. of Pers. Working in Futures Bus. Org.] (promulgated by the St. Council Sec. Comm’n Nov. 7, 1994, effective Nov. 7, 1994) (repealed 2000), available at [http://law.baidu.com/pages/chinalawinfo/1/8/fe426cc01ba804a104d29a212e99a39d\\_0.html](http://law.baidu.com/pages/chinalawinfo/1/8/fe426cc01ba804a104d29a212e99a39d_0.html) (last visited Mar. 30, 2009) (P.R.C).

25. Shanghai shi qi huo shi chang guan li gui ding [Regulations on the Admin. of Shanghai Futures Mkt.] (promulgated by the Shanghai Mun. Gov’t, Dec. 5, 1994, effective Jan. 1, 1995, Notice No. 87) (repealed 1999), available at [http://law.baidu.com/pages/chinalawinfo/1678/9/7bc476c608a726b5c8887a18cdedfd50\\_0.html](http://law.baidu.com/pages/chinalawinfo/1678/9/7bc476c608a726b5c8887a18cdedfd50_0.html) (last visited Mar. 30, 2009) (P.R.C).

26. See The Notice of the St. Council on Further Consolidation & Standardization of the Futures Mkt., *supra* note 17.

27. One of the principles stated in the 1993 Notice of the State Council on Firmly Stopping Blind Development of the Futures Market was “[t]o start in a standardized manner, strengthen legislation and to subject everything to experiment and strict control.” (*guifan qibu, jiaqiang lifa, yiqie jingguo shiyan he yange kongzhi*). See The Notice of the St. Council on Firmly Stopping Blind Dev. of the Futures Mkt., *supra* note 4.

commodity exchanges,<sup>28</sup> trading of foreign exchange futures<sup>29</sup> and government bond futures was suspended,<sup>30</sup> and offshore trading of commodity futures products was cancelled.<sup>31</sup>

In June 1999, the State Council made an important step in the regulation of the futures market by promulgating the 1999 Provisional Regulations,<sup>32</sup> the first formal regulations on futures trading. In August 1999, the China Securities Regulatory Commission (CSRC), which functions as the country's securities regulator by implementing the State Council's policy and formulating detailed securities regulatory rules, set forth four provisions in accordance with the 1999 Provisional Regulations.

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28. See Guowuyuan zheng quan wei yuan hui guan yu gong zhi gang cai, shi tang, mei tan qi huo jiao yi qing shi de tong zhi [Notice of the Gen. Office of the St. Council Relaying the St. Council Securities Comm. Asking for Instructions on Stopping Trading Futures of Steel, Sugar & Coal] (promulgated by the Gen. Office of the St. Council, Apr. 6, 1994), available at [http://www.law-lib.com/law/law\\_view.asp?id=57907](http://www.law-lib.com/law/law_view.asp?id=57907) (last visited Mar. 30, 2009) (P.R.C) (suspending further trading and listing of standard futures contracts of steel, sugar and coal).

29. See Guan yu guan che 'Guan yu yan li cha chu fei fa wai hui qi huo he wai hui an jin jiao yi huo dong de tong zhi' de hui yi ji yao de tong zhi [Notice on the Summary of the Meeting Implementing the Notice on Sternly Investigating and Dealing with Illegal Trading Activities in Foreign Exch. Futures & Foreign Exch. Deposit Trading] (promulgated jointly by the China Sec. and Regulation Comm., the St. Admin. of Foreign Exch., the St. Admin. for Indus. & Commerce, & the Ministry of Pub. Sec., Dec. 14, 1994), available at [http://www.law-lib.com/law/law\\_view.asp?id=59481](http://www.law-lib.com/law/law_view.asp?id=59481) (last visited Mar. 30, 2009) (P.R.C) [hereinafter The Notice on the Summary of the Meeting Implementing the Notice on Sternly Investigating & Dealing with Illegal Trading Activities in Foreign Exch. Futures & Foreign Exch. Deposit Trading]. The Notice stated that "in a long period of time in the future, our country will not engage in experimentation in these areas . . . ." See The Notice on the Summary of the Meeting Implementing the Notice on Sternly Investigating & Dealing with Illegal Trading Activities in Foreign Exch. Futures & Foreign Exch. Deposit Trading, *supra* note 29, at 1.

30. See Guan yu zan ting guo zhai qi huo jiao yi shi dian de jin ji tong zhi [Urgent Notice on Suspension of Trials of Gov't Bond Futures Trading] (promulgated by the China Sec. Regulatory Comm'n, May 17, 1995, repealed Apr. 9, 2002), available at [http://law.baidu.com/pages/chinalawinfo/1/26/0870d2f6e4724ce6053131f49d1970b0\\_0.html](http://law.baidu.com/pages/chinalawinfo/1/26/0870d2f6e4724ce6053131f49d1970b0_0.html) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter The Urgent Notice on Suspension of Trials of Gov't Bond Futures Trading]. According to the Notice, the trial of trading government bond futures was suspended with effect as of May 18, 1995, & May 31, 1995 was set as the deadline for clearing out existing positions by exchanges. See *id.*

31. See Guan yu qi huo jing ji gong si zhu xiao jing wai qi huo ye wu you guan wen ti de tong zhi [Notice on Relevant Issues about Cancellation by Futures Broker Firms of Offshore Futures Bus.] (promulgated by the China Sec. Regulatory Comm'n, Sept. 12, 1994) (repealed Apr. 10, 2000), available at <http://old.csrc.gov.cn/n575458/n575742/n2529771/2569013.html> (last visited Apr. 24, 2009) (P.R.C) [hereinafter The Notice on Relevant Issues about Cancellation by Futures Broker Firms of Offshore Futures Bus.]. This required futures broker firms to stop their offshore futures business with immediate effect, not to accept new customers, and not to take on new orders. See *id.*

32. Qi huo jiao yi guan li zan xing tiao li [Provisional Regulations on the Admin. of Futures Trading] (promulgated by the St. Council, June 2, 1999, effective from Sept. 1, 1999) (repealed 2007), available at <http://www.csrc.gov.cn/n575458/n6807967/n6808047/6808242.html> (last visited Apr. 24, 2009) (P.R.C.) [hereinafter The 1999 Provisional Regulations on the Admin. of Futures Trading]; The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5.



The four provisions effectuated the regulation of futures exchanges,<sup>33</sup> the regulation of futures broker firms,<sup>34</sup> the enactment of qualification requirements for senior managers in futures broker firms,<sup>35</sup> and the enactment of qualification requirements for entering into the futures business.<sup>36</sup> In January and May 2002, those four provisions were amended by the CSRC, changing some regulated areas, such as that of futures broker firms,<sup>37</sup> while adding more detailed provisions in others.<sup>38</sup> Altogether, the 1999 Provisional Regulations and the four CSRC provisions served as an impetus to the standardization of China's new futures market and also provided guidance to the people's courts, which were handling the influx of futures disputes.

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33. Qi huo jiao yi suo guan li ban fa [Measures on the Admin. of Futures Exch.] (promulgated by the China Sec. Regulatory Comm'n, Aug. 31, 1999), *available at* [http://law.baidu.com/pages/chinalawinfo/2/40/a424b0999501e67986303d9155bec527\\_0.html](http://law.baidu.com/pages/chinalawinfo/2/40/a424b0999501e67986303d9155bec527_0.html) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter The 1999 Measures on the Admin. of Futures Exch.].

34. Qi huo jing ji gong si guan li ban fa [Measures on the Admin. of Futures Broker Firms] (promulgated by the China Sec. Regulatory Comm'n, Aug. 31, 1999, effective Sept. 1, 1999) (repealed 2002), *available at* [http://law.baidu.com/pages/chinalawinfo/2/40/6334b1c89f774255c6c5e610840a1997\\_0.html](http://law.baidu.com/pages/chinalawinfo/2/40/6334b1c89f774255c6c5e610840a1997_0.html) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter The 1999 Measures on the Admin. of Futures Broker Firms].

35. Qi huo jing ji gong si gao ji guan li ren yuan ren zhi zi ge guan li ban fa [Measures on the Admin. of Qualifications for Appointment of Senior Mgmt. Pers. of Futures Broker Firms] (promulgated by the China Sec. Regulatory Comm'n, Aug. 31, 1999, effective Sept. 1, 1999), *available at* [http://finance.ce.cn/futures/qhpdqhx/qhjygz/200706/14/t20070614\\_11753454.shtml](http://finance.ce.cn/futures/qhpdqhx/qhjygz/200706/14/t20070614_11753454.shtml) (P.R.C.).

36. Qi huo ye gong ye ren yuan zi ge guan li ban fa, [Measures on the Admin. of Qualifications for Pers. Engaging in Futures Bus.] (promulgated by the China Sec. Regulatory Comm'n, Aug. 31, 1999, effective Sept. 1, 1999), *available at* <http://www.stockstar.com/info/darticle.aspx?id=GA,20010705,00005036> (last visited Mar. 30, 2009) (P.R.C.).

37. For example, futures broker firms were allowed to engage in futures consultancy and training business under Article 6 (2) of the 2002 Measures on the Administration of Futures Broker Firms while this provision was not spelled out in the 1999 Measures on the Administration of Futures Broker Firms. *See* The 1999 Measures on the Admin. of Futures Broker Firms, *supra* note 34; Qi huo jing ji gong si guan li ban fa [Measures on the Admin. of Futures Broker Firms] Art. 6 (2), (promulgated by the China Sec. Regulatory Comm'n, May 17, 2002, effective July 1, 2002), *available at* <http://old.csrc.gov.cn/n575458/n776436/n805040/n825027/1988508.html> (last visited Apr. 24, 2009) (P.R.C.).

38. For example, the 2002 Measures on the Administration of Futures Exchanges has more detailed provisions concerning deposits made by members of a futures exchange than the 1999 Measures on the Administration of Futures Exchanges. *See* The 1999 Measures on the Admin. of Futures Exch., *supra* note 33; Qi huo jiao yi suo guan li ban fa [Measures on the Admin. of Futures Exch.] (promulgated by China Sec. Regulatory Comm'n, May 17, 2002, effective July 1, 2002, repealed 2007), *available at* <http://old.csrc.gov.cn/n575458/n776436/n805040/n825027/1988517.html> (last visited Apr. 24, 2009) (P.R.C.) [hereinafter The 2002 Measures on the Admin. of Futures Exch.]; Qi huo jiao yi suo guan li ban fa [Measures on the Admin. of Futures Exch.] (promulgated by the China Sec. Regulatory Comm'n, Apr. 9, 2007, effective Apr. 15, 2007), *available at* <http://www.csrc.gov.cn/n575458/n870416/n1337670/n3955943.files/n3955942.doc> (last visited Apr. 24, 2009) (P.R.C.) [hereinafter The 2007 Measures on the Admin. of Futures Exch.].

The Asian financial crisis erupted in 1997–1998, pushing many countries into recession and threatening China’s financial system.<sup>39</sup> Two years later, in late 1999, only a limited number of state-owned enterprises were allowed to engage in offshore trading of commodities futures products for hedging purposes, and even those transactions were subject to approval by government regulators.<sup>40</sup> A number of protocols were issued to regulate and facilitate this activity, including the Notice on Relevant Issues about Application for Offshore Futures Business<sup>41</sup> and the Administrative Measures on Offshore Futures Hedging Business by State-owned Enterprises.<sup>42</sup> Under these protocols, central government approval was required for any engagement in offshore trading of commodities futures products by state-owned enterprises.<sup>43</sup> Such engagements also needed to meet conditions set out in Articles 6,<sup>44</sup> 7 and 8 of the Administrative Measures on Offshore Futures Hedging Business by State-owned Enterprises.<sup>45</sup> These regulatory requirements and procedures reflected the

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39. For a general discussion about the 1997–1998 Asian financial crisis, see *THE ASIAN FINANCIAL CRISIS AND THE ARCHITECTURE OF GLOBAL FINANCE* (Gregory W. Noble & John Ravenhill eds., Cambridge University Press, 2000).

40. See *infra* notes 42, 43 and accompanying text.

41. See *Guan yu shen qing jing wai qi huo ye wu guan wen ti de tong zhi* [Notice on Relevant Issues about Application for Offshore Futures Bus.] (promulgated jointly by the China Sec. Regulatory Comm’n, St. Econ. & Trade Comm’n, St. Admin. for Indus. & Commerce, & St. Admin. of Foreign Exch., Oct. 15, 1999, effective Oct. 15, 1999) (repealed 2003), available at [http://www.gov.cn/gongbao/content/2000/content\\_60613.htm](http://www.gov.cn/gongbao/content/2000/content_60613.htm) (last visited Mar. 30, 2009) (P.R.C.).

42. *Guo you qi ye jing wai qi huo tao qi bao zhi ye wu guan li ban fa* [Admin. Measures on Offshore Futures Hedging Bus. by State-owned Enters.] (promulgated jointly by the China Sec. Regulatory Comm’n, St. Bureau of Foreign Exch., St. Econ. & Trade Comm’n, Ministry of Foreign Trade & Econ. Coop., & St. Admin. for Indus. & Commerce, May 24, 2002, effective May 24, 2002), available at <http://www.stockstar.com/info/darticle.aspx?id=GA,20011022,00005122> (last visited Mar. 30, 2009) (P.R.C.) [hereinafter *The Admin. Measures on Offshore Futures Hedging Bus. by State-owned Enters.*].

43. Article 5 (1) of the *The Administrative Measures on Offshore Futures Hedging Business by State-owned Enterprises* states that enterprises engaging in offshore futures business must be approved by the State Council. See *The Admin. Measures on Offshore Futures Hedging Bus. by State-owned Enters.*, *supra* note 42, at Art. 5 (1).

44. Article 6 sets out a list of conditions for engagement in offshore futures business by state-owned enterprises including, among others, that the enterprise has import and export rights (art. 6 (2)); there is definitely a hedging need in offshore futures market for import and export commodities or other commodities purchased or sold on offshore spot market (art. 6 (3)); there is a sound and comprehensive management system for offshore futures business (art. 6 (4)); and there are at least three persons who have offshore futures business experience over one year and who have obtained qualifications certified by the CSRC or offshore futures regul. ators, including special futures risk management person, and there is at least one senior management person who know offshore futures trading and who have satisfied other requirements of the CSRC. See *The Admin. Measures on Offshore Futures Hedging Bus. by State-owned Enters.*, *supra* note 42, at Art. 6.

45. Article 7 requires an applicant enterprise to submit a list of application documents including, among others, a business license and qualification as an import and export enterprise; Article 8 requires the applicant enterprise, once approved, to obtain the relevant licenses and register with the relevant authorities before engaging in offshore futures trading. See *The Admin. Measures on Offshore Futures Hedging Bus. by State-owned Enters.*, *supra* note 42, at Art. 7–8.

government's cautious position that offshore trading was necessary only insofar as to hedge against risks arising from fluctuation of exchange rates or other international market risks; otherwise speculative offshore trading was not permissible.<sup>46</sup>

In December 2001, China formally became a member of the World Trade Organization (WTO)<sup>47</sup> and began to implement its WTO commitments in the financial services sectors, including its commitment to open China's securities market to foreign investment.<sup>48</sup> In November 2002, the 16<sup>th</sup> National Congress of the Communist Party of China set out a strategic goal of developing China into a "well-off society" (*xiaokang shehui*).<sup>49</sup> In October 2003, the Third Plenary Session of the 16<sup>th</sup> Central Committee of the Communist Party of China sought to further China's policy goals by outlining major tasks to further improve China's market economy.<sup>50</sup> China's capital market was scrutinized by the central government under the policy decisions made by the 16<sup>th</sup> National Congress of the Communist Party of China and its Third Plenary Session, leading to the State Council's issuance of Several Opinions on Promoting the Reform, Opening-up and Steady Development of China's Capital Market in 2004

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46. Article 37(1) of the The Administrative Measures on Offshore Futures Hedging Business by State-owned Enterprises grants the CSRC the power to conduct routine inspections of the state-owned enterprises who are licensed to engage in offshore trading of commodities futures products. Such inspections include whether the enterprise carries out speculative trading. See The Admin. Measures on Offshore Futures Hedging Bus. by State-owned Enters., *supra* note 42, at Art. 37 (1).

47. On November 10, 2001, a signing ceremony on China's accession to the WTO was held at Doha, following which China formally became a member of the WTO on December 11, 2001. See Press Release, World Trade Organization, WTO Ministerial Conference Approves China's Accession (Nov. 10, 2001), available at [http://www.wto.org/english/news\\_e/pres01\\_e/pr252\\_e.htm](http://www.wto.org/english/news_e/pres01_e/pr252_e.htm).

48. See Zhu Sanzhu, *Implementing China's WTO Commitments in Chinese Financial Services Law*, THE CHINA REVIEW, Vol. 6 (2), 3-33 (Fall 2006), available at <http://cup.cuhk.edu.hk/ojs/index.php/ChinaReview/article/view/176>. In particular, see the section titled *Securities*, at 14-21.

49. The 16th National Congress of the Communist Party of China was held on November 8, 2002, in which then-president Jiang Zemin made a speech entitled "Build a Well-off Society in an All-Round Way and Create a New Situation in Building Socialism with Chinese Characteristics." In his speech, President Jiang set out the goals for achieving a well-off society, one of which was China's GDP would be quadrupled by 2020 from the level in 2000. See Jiang Zemin, President, 16th Nat'l Cong. of the Communist Party of China, Address at the 16th Nat'l Cong. of the Communist Party of China: Build a Well-off Society in an All-Round Way and Create a New Situation in Building Socialism with Chinese Characteristics (Nov. 8, 2002), available at [http://news.xinhuanet.com/ziliao/2002-11/17/content\\_693542.htm](http://news.xinhuanet.com/ziliao/2002-11/17/content_693542.htm) (last visited Mar. 30, 2009).

50. The Third Plenary Session of the 16th Central Committee of the Communist Party of China adopted the Decision on the Improvement of the Socialist Market Economic System dated October 14, 2003. The Decision outlined tasks to further improve China's market economy to build a well-off society, covering a wide range of areas of economic system. For example in Section 3, it covered state-owned enterprise reform, and in Section 7, financial system reform. Zhong gong Zhong yang guan yu wan shan she hui zhu yi shi chang jing ji ti zhi ruo gan wen ti de jue ding [Decision on the Improvement of the Socialist Mkt. Econ. System] Sec. 3, Sec. 7, (adopted by the 16th Cent. Comm. of the Communist Party of China, Oct. 14, 2003), available at <http://www.people.com.cn/GB/shizheng/1024/2145119.html>.

(commonly known as the “Nine-point Opinion”).<sup>51</sup> The Nine-point Opinion represented the central government’s assessment and comprehensive policy for the future of China’s capital market. In previous years, the State Council had made similar policy statements on China’s capital market<sup>52</sup> that focused more on efficient regulation of China’s emerging securities market; in contrast, however, the Nine-point Opinion focused specifically on the opening-up and steady development of China’s capital market.<sup>53</sup>

China’s financial futures market was re-established in the two years following the issuance of the Nine-point Opinion. Trading of government bond futures and financial bond futures resumed on June 15, 2005 via an inter-bank bond market, and the People’s Bank of China promulgated a group of regulations and trading rules.<sup>54</sup> The establishment of the CFFEX in 2006<sup>55</sup> was a long-awaited and welcome move. It was accompanied by a new set of trading rules covering, among other things, financial futures trading,<sup>56</sup> financial futures settlement,<sup>57</sup> and risk control management by a financial futures exchange.<sup>58</sup> Unlike the uncontrolled growth in the early 1990s, the re-establishment of the financial futures market and the

51. Guowuyuan guan yu tui jin zi ben shi chang gai ge kai fang he wen ding fa zhan de ruo gan yi jian [Several Opinions of the St. Council on Promoting the Reform, Opening-up & Steady Development of China’s Capital Mkt.] (announced by the St. Council, Jan. 31, 2004), *available at* [http://news.xinhuanet.com/zhengfu/2004-02/02/content\\_1293905.htm](http://news.xinhuanet.com/zhengfu/2004-02/02/content_1293905.htm) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter Several Opinions of the St. Council on Promoting Reform, Opening-up & Steady Development of China’s Capital Mkt.].

52. *See* Guowuyuan guan yu jin yi bu jia qiang zheng quan shi chang hong guan guan li de tong zhi [The Notice of the St. Council on Further Strengthening Macro-administration of the Sec. Mkt.] (promulgated by the St. Council, Dec. 17, 1992), *available at* [http://law.baidu.com/pages/chinalawinfo/0/60/aad147dca12dac5abe2f2c15d32a3a5b\\_0.html](http://law.baidu.com/pages/chinalawinfo/0/60/aad147dca12dac5abe2f2c15d32a3a5b_0.html) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter The Notice of the St. Council on Further Strengthening Macro-administration of the Sec. Mkt.].

53. *See* Several Opinions of the St. Council on Promoting Reform, Opening-up & Steady Development of China’s Capital Mkt., *supra* note 51, (stating China should “[s]teadily develop the futures market” and “develop derivative products related to stocks and bonds . . .”).

54. *See* Quan guo yin hang jian zhai quan shi chang zhai quan yuan qi jiao yi guan li gui ding [Provisions on the Admin. of Bond Futures Trading on Nat’l Inter-bank Bond Mkt.] (promulgated by the People’s Bank of China, May 11, 2005, effective June 15, 2005), *available at* [http://law.baidu.com/pages/chinalawinfo/5/82/723a947d4ec7347c615e398ced222ceb\\_0.html](http://law.baidu.com/pages/chinalawinfo/5/82/723a947d4ec7347c615e398ced222ceb_0.html) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter The Provisions on the Admin. of Bond Futures Trading on Nat’l Inter-bank Bond Mkt.].

55. *See* China Financial Futures Exchange Home Page, <http://www.cffex.com.cn> (follow “About the Exchange” (“Guan yu Jiao Yi Suo”) hyperlink) (last visited Feb. 20, 2009).

56. *See* Trading Rules of China Financial Futures Exchange, [http://www.cffex.com.cn/wps/wcm/connect/cffex\\_dev/CFEX\\_EN/SiteArea\\_RulesRegulation/SiteArea\\_CFFXRules/rules2008051902](http://www.cffex.com.cn/wps/wcm/connect/cffex_dev/CFEX_EN/SiteArea_RulesRegulation/SiteArea_CFFXRules/rules2008051902); *see also* Detailed Trading Rules of China Financial Futures Exchange, [http://www.cffex.com.cn/wps/wcm/connect/cffex\\_dev/CFEX\\_EN/SiteArea\\_RulesRegulation/SiteArea\\_CFFXRules/rules2008051904](http://www.cffex.com.cn/wps/wcm/connect/cffex_dev/CFEX_EN/SiteArea_RulesRegulation/SiteArea_CFFXRules/rules2008051904).

57. Detailed Clearing Rules of China Financial Futures Exchange, [http://www.cffex.com.cn/wps/wcm/connect/cffex\\_dev/CFEX\\_EN/SiteArea\\_RulesRegulation/SiteArea\\_CFFXRules/rules2008051905](http://www.cffex.com.cn/wps/wcm/connect/cffex_dev/CFEX_EN/SiteArea_RulesRegulation/SiteArea_CFFXRules/rules2008051905).

58. Measures of China Financial Futures Exchange on the Administration of Risk Control, [http://www.cffex.com.cn/wps/wcm/connect/cffex\\_dev/CFEX\\_EN/SiteArea\\_RulesRegulation/SiteArea\\_CFFXRules/rules2008051908](http://www.cffex.com.cn/wps/wcm/connect/cffex_dev/CFEX_EN/SiteArea_RulesRegulation/SiteArea_CFFXRules/rules2008051908).

introduction of financial futures products after 2004 were part of the continuing and sustainable development of China's securities market. The specific regulations and rules promulgated to facilitate and regulate the re-establishment of the financial futures market were an extension of the securities and futures regulatory framework established by the 1998 Securities Law, as amended in 2005 (2005 Securities Law)<sup>59</sup> and the 1999 Provisional Regulations.

The 1999 Provisional Regulations were amended comprehensively, including an increase of twenty new articles in the 2007 Regulations.<sup>60</sup> Important changes included the relaxation of a previous ban on financial institutions engaging in futures trading,<sup>61</sup> the creation of a futures investors protection fund,<sup>62</sup> and the introduction of a division system between settlement members (*jiesuan huiyuan*) and non-settlement members (*fei jiesuan huiyuan*).<sup>63</sup> On the whole, the 2007 Regulations designed a balanced regulatory framework for China's commodity and financial futures market by lifting some unnecessary restrictions on normal futures trading activities and participants; however, the 2007 Regulations also cautiously implemented strong government supervision of the market.

Out of the ninety-one articles in the 2007 Regulations, about twenty-five articles left a provision open<sup>64</sup> or referred certain matters to regulations

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59. Zheng quan fa [Securities Law], (adopted by the Standing Comm. of the Nat'l People's Cong., Dec. 29, 1998, effective July 1, 1999, amended Oct. 27, 2005, effective Jan. 1, 2006), available at <http://www.csrc.gov.cn/n575458/n870399/n1337876/2052726.html> (last visited Apr. 24, 2009) (P.R.C.) [hereinafter Securities Law].

60. The 2007 Regulations on the Administration of Futures Trading has 91 articles, an increase from 71 articles in the 1999 Provisional Regulations on the Administration of Futures Trading. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5.

61. Art. 30 of the 1999 Provisional Regulations on the Administration of Futures Trading listed a number of institutions and individuals, including financial institutions, who may not engage in futures trading and for whom futures broker firms may not accept entrustments to trade futures. See The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 30. Article 26 of the 2007 Regulations on the Administration of Futures Trading has now removed financial institutions from this list. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 26.

62. See Qi huo tou zi zhe bao zhang ji jin guan li zhan xing ban fa [Provisional Measures on the Admin. of Futures Investors Protection Fund] (issued in accordance with Art. 54 of the 2007 Regulations on the Admin. of Futures Trading by the CSRC & the Ministry of Fin., Apr. 19, 2007, effective Aug. 1, 2007), available at <http://www.csrc.gov.cn/n575458/n4239016/n6634558/n9768098/n9768555/9851522.html> (last visited Mar. 30, 2009) (P.R.C.); The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 54.

63. In accordance with Article 8 of the 2007 Regulations on the Administration of Futures Trading, futures exchanges may adopt a system of membership consisted of settlement members and non-settlement members. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 8.

64. For example, Article 16 stipulates a list of conditions for establishment of a futures company, the last one of which is "any other criteria stipulated by the futures supervision and administration department of the State Council." See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 16.

yet to be issued.<sup>65</sup> As a result, the four implementing provisions of the 1999 Provisional Regulations, as amended in 2002, were again amended to accommodate the 2007 Regulations.<sup>66</sup> Apart from the uncertainty and confusion the open provisions created, full operation of the regulatory system under the 2007 Regulations remained, and still remains, dependent on those regulations and provisions not yet issued; this leaves the regulatory system vulnerable to inconsistency amidst the competing interests of government authorities.

In contrast to the tentative and ad-hoc regulations and regulatory documents in the early 1990s, China has gradually established a legal and regulatory framework for the commodity and financial futures market, with the 2007 Regulations at its center. However, one remaining issue is whether a special futures law will ultimately be enacted to regulate the market. The drafting process for a law governing futures trading started in the early 1990s, but was suspended during the government's campaign to stop a blind expansion of China's futures market.<sup>67</sup> However, China did not similarly delay the drafting of securities laws.

After the establishment of the Shanghai and Shenzhen Stock Exchanges in 1990 and 1991, respectively, and the promulgation of the Company Law in 1993, China commenced drafting its securities laws, leading to the enactment of the Securities Law in 1998, which was later amended in 2005.<sup>68</sup> In 1997, the first securities investment fund regulation was

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65. For example, in accordance with Article 46, measures concerning offshore futures trading by institutions or individuals shall be formulated by the futures regulator of the State Council in consultation with a number of other government departments and regulators, such as foreign exchange authority, and be approved by the State Council. *See* The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 46.

66. *See* Qi huo gong si dong shi, jian shi he gao ji guan li ren yuan ren zhi zi ge guan li ban fa [Measures on the Admin. of Qualifications for Appointment of Senior Mgmt. Personnel of Futures Broker Firms, *renamed as* Measures on the Admin. of Qualifications for Appointment of Dirs., Supervisors & Senior Mgmt. Personnel of Futures Co.] (amended & effective July 4, 2007), *available at* [http://law.baidu.com/pages/chinalawinfo/9/49/4845a83bf768bf09961ce784d2f35154\\_0.html](http://law.baidu.com/pages/chinalawinfo/9/49/4845a83bf768bf09961ce784d2f35154_0.html) (last visited Mar. 30, 2009) (P.R.C.). *See also* Qi huo cong ye ren yuan guan li ban fa [Measures on the Admin. of Qualifications for Pers. Engaging in Futures Bus., *renamed as* Measures on the Admin. of Pers. Engaging in Futures Bus.] (amended & effective July 4, 2007), *available at* [http://law.baidu.com/pages/chinalawinfo/9/49/f3480fcde09dad9111cc58d64b9b429e\\_0.html](http://law.baidu.com/pages/chinalawinfo/9/49/f3480fcde09dad9111cc58d64b9b429e_0.html) (last visited Mar. 30, 2009) (P.R.C.); The 2002 Measures on the Admin. of Futures Exch., *supra* note 38; The 2007 Measures on the Admin. of Futures Exch., *supra* note 38; Qi huo gong si guan li ban fa [Measures on the Admin. of Futures Broker Firms, *renamed as* Measures on the Admin. of Futures Co.] (amended Mar. 28, 2007, effective Apr. 15, 2007), *available at* [http://law.baidu.com/pages/chinalawinfo/8/99/2992c77ed3000eeb05ffbc53ede72db4\\_0.html](http://law.baidu.com/pages/chinalawinfo/8/99/2992c77ed3000eeb05ffbc53ede72db4_0.html) (last visited Mar. 30, 2009) (P.R.C.) [hereinafter The Measures on the Admin. of Futures Co.].

67. *See* CIVIL LIABILITIES OF FUTURES TRADING, *supra* note 14, at Preface, 1.

68. The Shanghai Stock Exchange was formally established in November 26, 1990 and the Shenzhen Stock Exchange in December 1, 1990. *See* About Shanghai Stock Exchange, <http://www.sse.com.cn/sseportal/ps/zhs/sjs/jysjs.shtml> (last visited Apr. 24, 2009); *see also* About Shenzhen Stock Exchange, <http://www.szse.cn/main/aboutus/bsjs/bsjj/index.shtml> (last visited Apr. 24, 2009). The Company Law of the People's Republic of China was China's first company law since the founding of the People's Republic of China in 1949. The drafting of the 1998

approved by the State Council and promulgated by the State Council Securities Committee.<sup>69</sup> In response to the substantial growth of the securities investment fund market since the late 1990s,<sup>70</sup> the securities investment fund regulations, which were originally issued in 1997, were upgraded and incorporated in the 2003 Securities Investment Fund Law.<sup>71</sup> Presently, the 2005 Securities Law and the 2003 Securities Investment Fund Law stand as the two prominent securities laws enacted by the Standing Committee of the National People's Congress.<sup>72</sup>

One issue is whether a separate futures law should operate alongside the 2005 Securities Law and the 2003 Securities Investment Fund Law, or alternatively, whether the regulation of the futures market should fall within the purview of the 2005 Securities Law with supplemental support from further administrative regulations covering specific issues of futures market and futures trading. Some judges, regulators and scholars advocate for a comprehensive futures law so that China may develop a market of financial futures products, such as foreign exchange futures and share index futures.<sup>73</sup> Given that the financial futures and commodity futures markets in China are expected to develop substantially in the future in line with China's economic growth and further reform towards a market economy,<sup>74</sup>

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Securities Law went through a longer period of time than its sister legislation, the 1993 Company Law. See *supra* note 8 and accompanying text. For the drafting process of the 1998 Securities Law, see Zhu Sanzhu, SECURITIES REGULATION IN CHINA (2000), in particular, ch. 1, Sec. B, at 8–14 [hereinafter SECURITIES REGULATION IN CHINA].

69. Zheng quan tou zi ji jin guan li zan xing ban fa [Provisional Measures on the Admin. of Sec. Inv. Fund] (approved by the St. Council Nov. 5, 1997, promulgated by the St. Council Sec. Comm., Nov. 14, 1997), available at <http://www.people.com.cn/item/flfgk/gwyfg/1997/112203199706.html> (P.R.C.).

70. In March 1998, two investment funds were first created after the promulgation of the Provisional Measures on the Administration of Securities Investment Fund in November 1997. By the end of 1998, there were only 5 investment funds, with a total net value 10.74 billion yuan; by the end of 2006, in contrast, there were 307 investment funds, with a net value 856.5 billion yuan. See Wo guo zheng quan tou zi ji jin ye fa zhan gai kuang [An Outline of the Development of Securities Investment Fund Sector in Our Country], CHINA SECURITIES DAILY, July 29, 2008, available at [http://finance.ce.cn/fund/shou/jjgdbd/200809/27/t20080927\\_13674043.shtml](http://finance.ce.cn/fund/shou/jjgdbd/200809/27/t20080927_13674043.shtml).

71. Zheng quan tou zi ji jin fa [Securities Investment Fund Law] (adopted by the Standing Comm. of the Nat'l People's Cong., Oct. 28, 2003, effective June 1, 2004), available at <http://www.china.org.cn/english/government/207330.htm> (last visited Mar. 30, 2009) (P.R.C.).

72. In March 2006, a drafting team was set up with a task to resume the drafting process of the Futures Trading Law. Since then the drafting team has been working on the draft and made substantial progresses. See Ron Fang & Peng Yong, Wo guo qi huo jiao yi li fa qu de zhong da jin zhan [Significant Progress has been Made with Legislation of Futures Trading of Our Country], XINHUANET, Dec. 4, 2007, available at [http://news.xinhuanet.com/finance/2007-12/04/content\\_7337739.htm](http://news.xinhuanet.com/finance/2007-12/04/content_7337739.htm). When the Futures Trading Law is passed by the Standing Committee of the National People's Congress, China's securities primary law will be a tripartite body consisting of the Securities Law, Securities Investment Fund Law and Futures Trading Law.

73. See CIVIL LIABILITIES OF FUTURES TRADING, *supra* note 14, at Preface, 2–3.

74. For example, trading of steel futures contracts, which was suspended in 1994, was recently launched in Shanghai Futures Exchange on March 27, 2009. The launch of futures contracts for two construction steel products – reinforcing steel bar and wire rod – is seen as a major event in China, the world's largest producer and consumer of the metal. It "is hailed as a sign that China's

the promulgation of a futures law represents a sensible step towards promoting a set of uniform principles and rules for the regulation and development of China's futures market, and for the resolution of disputes arising in the futures market.

### III. DEVELOPMENT OF PRINCIPLES AND PROCEDURES FOR THE RESOLUTION OF DISPUTES ARISING FROM FUTURES TRADING

In the futures market's formative years, the number of futures trading disputes increased sharply and flooded the people's courts. In the words of the deputy president of the Supreme People's Court, the futures market had become a "big litigation family" (*susong dahu*), generating a high rate of disputes and litigation,<sup>75</sup> and presenting new and difficult issues before the people's courts. Furthermore, these complicated disputes often involved large sums of money, and in some cases were multi-party litigation.<sup>76</sup> This highly visible rise in litigation prompted the Supreme People's Court to create some guidelines to direct the local courts dealing with futures dispute cases.

In April 1995, the Supreme People's Court held a symposium to discuss the issues arising from the adjudication of futures disputes in the people's courts.<sup>77</sup> Judges from fourteen high people's courts and six intermediate people's courts attended the symposium<sup>78</sup> to address prominent issues of concern, including the principles for handling futures cases, the jurisdiction of the people's courts over futures cases, the qualifications necessary to engage in futures trading, the legal status and civil liability of brokers, the nature of contract and tort liability, the invalid civil acts relating to futures transactions and the determination of civil liabilities of such acts,<sup>79</sup> the

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steel industry has taken an important step forward in the process of marketization." See Chinamining.org, Analysis: China's Launch of Steel Futures May Change Global Pricing System, Mar. 30, 2009 <http://www.chinamining.org/News/2009-03-30/1238374395d23043.html>; see also Steve James, *Chinese Steel Futures Market Scheduled for Launch Today*, REUTERS, Mar. 27, 2009, <http://www.mineweb.com/mineweb/view/mineweb/en/page39?oid=80939&sn=Detail>.

75. See *Zui gao ren min fa yuan guan yu shen li qi huo jiu fen an jian ruo gan wen ti de gui ding' de li jie yu shi yong* [UNDERSTANDING AND APPLICATION OF 'THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT ON SEVERAL ISSUES CONCERNING ADJUDICATION OF CASES OF FUTURES DISPUTES'] Preface, 1 (compiled by the Second Division Court of the Supreme People's Court), (Jiang Bixin, ed., Beijing: the People's Court Publishing House, 2003) [hereinafter UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT].

76. For example, *Xiamen Guomao Group Co. Ltd. by Shares & Others v. Hainan Zhongqing Jiye Dev. Ctr.*, a case dealing with trading of natural rubber futures contracts, involved eighteen corporate plaintiffs and millions of  *yuan*. See UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 296–312.

77. The 1995 SPC Futures Judicial Guidelines, *supra* note 7.

78. See The 1995 SPC Futures Guidelines, *supra* note 7.

79. For example, even if a futures broker firm engages in futures brokerage business without approval and without a license, it shall not be held liable if there is evidence proving that the broker firm carried out the futures trading in accordance with the client's instructions. In such a



trading of foreign exchange deposits, and the applicable burden of proof in futures cases.<sup>80</sup>

In October 1995, the Supreme People's Court issued the 1995 SPC Futures Judicial Guidelines,<sup>81</sup> which enumerated the April symposium's positions and served as the Court's comprehensive response to the problematic increase of futures disputes in the people's courts. The 1995 SPC Futures Judicial Guidelines emphasized that the people's courts' main tasks were to deal with futures disputes fairly and expediently, to protect the lawful rights and interests of the parties, to punish illegal trading activities, and to maintain order in the futures market.<sup>82</sup> The people's courts embraced the 1995 SPC Futures Judicial Guidelines and they became the first comprehensive set of provisional guidelines addressing substantial and procedural issues in the adjudication of futures disputes.

In addition to the Supreme People's Court's April symposium, local regulatory bodies held similar seminars and discussions. For example, in Shanghai, the location of several futures exchanges and the site of active and substantial futures trading, the Shanghai Securities Regulatory Office, in conjunction with the Shanghai Commodity Exchange, the Metal Exchange and the Grain & Oil Exchange, organized a seminar in June 1998 to discuss how to deal with futures disputes arising particularly in the futures market of Shanghai.<sup>83</sup> Participants included judges from the Shanghai High People's Court and several intermediate and district courts in Shanghai.<sup>84</sup> Such local seminars were a response to the increasing number of futures disputes and sought to address issues and problems that were not fully addressed by the 1995 SPC Futures Judicial Guidelines.

The Supreme People's Court constructed a new set of guidelines in July 1999, based on the 1995 SPC Futures Judicial Guidelines and the people's courts' experiences with futures cases. After four stages of drafting and twenty-eight drafts,<sup>85</sup> the new guidelines were finalized in May 2003.<sup>86</sup> The 2003 Provisions of the Supreme People's Court on Several Issues

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case, the loss suffered by the client was merely caused by normal market risk. *See* The 1995 SPC Futures Guidelines, *supra* note 7, at Sec. 7.

80. *See* The 1995 SPC Futures Guidelines, *supra* note 7, at Secs. 8 and 9.

81. *See* The 1995 SPC Futures Judicial Guidelines, *supra* note 7.

82. The 1995 SPC Futures Guidelines, *supra* note 7.

83. *See The Summary of Shanghai Seminars on Handling Futures Trading Disputes*, *supra* note 7, at 226–33.

84. Qi huo jiao yi jiu fen an li ping xi [COMMENTARY AND ANALYSIS ON FUTURES TRADING DISPUTE CASES] 226–33 (Zhong Futang et al. eds., Shanghai: Xuelin Publishing House, 1998).

85. The drafting started on July 21, 1999. The first stage was to work on the new issues and questions emerged since 1995 and to incorporate them into the drafts; starting from May 2001, the second stage was to focus on the structure; starting from early 2002, the third stage was to consult with the CSRC, futures exchanges and the Association of Futures Business; during February and May 2003, the fourth stage was to go through several rounds of discussions by the Adjudication Committee of the Supreme People's Court. *See* UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 18–19.

86. *See* The 2003 SPC Futures Judicial Provisions, *supra* note 7.

Concerning Adjudication of Cases of Futures Disputes (2003 SPC Futures Judicial Provisions)<sup>87</sup> were the product of careful work based on consultation with the futures business sector and market regulators.<sup>88</sup> They represented a unified understanding of major civil law issues concerning the futures market as recognized by the people's courts, the regulators and the futures business.<sup>89</sup> Compared with the 1995 SPC Futures Judicial Guidelines, the 2003 SPC Futures Judicial Provisions provided the people's courts with more mature and settled guidelines for handling futures disputes. For example, the 2003 SPC Futures Judicial Provisions refined the 1995 SPC Futures Judicial Guidelines' position regarding the burden of proof in cases where a futures broker firm may not have carried out a client's trading instruction in the market.<sup>90</sup> Also, the 2003 SPC Futures Judicial Provisions made clear that the amount of positions that a futures exchange or a futures broker firm closes out must equal the margin of that futures broker firm or that of its client; the loss caused by an excessive liquidation would be borne by those forcing liquidation.<sup>91</sup> Such an equity-based principle regarding excessive liquidation was absent in the 1995 SPC Futures Judicial Guidelines and the 1999 Provisional Regulations.<sup>92</sup>

The 1995 SPC Futures Judicial Guidelines recognized features of futures disputes which were distinct from other economic disputes. The guidelines set forth specific principles by which the people's courts should handle such distinctions,<sup>93</sup> including correctly applying the law,<sup>94</sup> balancing

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87. The 2003 SPC Futures Judicial Provisions, *supra* note 7.

88. It took nearly four years for the Supreme People's Court to complete the draft, during which time it consulted with the CSRC, various futures exchanges and the Association of Futures Business. See *The Summary of Shanghai Seminars on Handling Futures Trading Disputes*, *supra* note 7, at 227.

89. This was discussed in an interview by a news reporter with Jiang Bixin, deputy president of the Supreme People's Court, on the application of the 2003 Provisions of the Supreme People's Court on Several Issues Concerning Adjudication of Cases of Futures Disputes. See UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 19.

90. See *Wang Huiwen v. Zhuhai City Xinguang Futures Brokerage Co.*, in the Gazette of the Supreme People's Court, issue 1, 1999, at 29–30 (P.R.C.). See also *infra* notes 173–78, 180–83, 186 and accompanying text.

91. Article 39 the 2003 SPC Futures Judicial Provisions states that “the amount of positions that a futures exchange or a futures broker firm close out should be basically equal to the amount of margin that a futures broker firm or a client has to add up. The loss caused by an excessive liquidation shall be borne by those who take the forced liquidation measure.” The 2003 SPC Futures Judicial Provisions, *supra* note 7, at Art. 39.

92. Section Five (Point 6) of the 1995 SPC Futures Judicial Guidelines and Article 41 of the 1999 Provisional Regulations addressed the issue of forced liquidation but neither of them addressed the issue of excessive forced liquidation and consequent liabilities. See *The 1995 SPC Futures Judicial Guidelines*, *supra* note 7, at Sec. 5, Point 6; see also *The 1999 Provisional Regulations on the Admin. of Futures Trading*, *supra* note 32, at Art. 41.

93. See *The 1995 SPC Futures Guidelines*, *supra* note 7, at Sec. 1.

94. Section One (1) states that the people's courts should apply the 1986 General Principles of Civil Law as a primary source of law and also act in light of central and local administrative regulations and normative documents; where the disputes involve foreign, Hong Kong and Macao

between risks and interests,<sup>95</sup> balancing between fault and responsibilities,<sup>96</sup> and respecting the agreement of the parties.<sup>97</sup> These principles were reiterated in the 2003 SPC Futures Judicial Provisions<sup>98</sup> and continued to guide the people's courts handling futures dispute cases.<sup>99</sup> In essence, these principles were an extension and application of the legal principles stated in the 1986 GPCL,<sup>100</sup> the 1999 Contract Law,<sup>101</sup> and other relevant primary laws.<sup>102</sup> The general legal principles of the 1986 GPCL and the 1999 Contract Law applied to all types of civil and commercial activities in China, while other relevant primary laws applied to the activities in their respective areas. Together, they remain a source of legal principles which the people's courts use to formulate specific principles applicable to certain types of disputes.

In addition to the judicial resolution of futures disputes, non-judicial resolution by professional associations has played an important role in the development of futures trading regulation. The Securities Association of China (SAC), established in August 1991, was China's first national, self-regulatory professional association for the securities industry; it maintains

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element, the people's courts should also refer to international practice. *See* The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 1 (1).

95. Section One (2) states that, given the fact that futures trading involve speculation and high risks, the people's courts should protect lawful interests of trading parties on the one hand, and determine correctly the risks the parties should undertake. *See* The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 1 (2).

96. Section One (3) states that the people's court should analysis carefully whether parties in a dispute are at fault, what is the nature of the fault, how serious is the fault, and whether there is a casual link between the fault and losses, and on the basis of these finding determine their corresponding responsibilities. *See* The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 1 (3).

97. Section One (4) states that the agreement of the parties should be treated as the basis for dealing with the disputes between the parties as long as the agreement has no violation of law, regulations and custom of futures trading. *See* The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 1 (4).

98. *See* The 2003 SPC Futures Judicial Provisions, *supra* note 7, at Arts. 1-3.

99. *See* The 2003 SPC Futures Judicial Provisions, *supra* note 7, at Arts. 1-3 (Art. 1. "When adjudicating futures disputes, the people's courts shall act in accordance with the law to protect the legal rights and interests of the parties, determine correctly the risk and responsibilities each party bears, and uphold the order of futures markets. Art. 2. When adjudicating futures contract disputes, the people's courts shall determine the the liability of the party who breaches the contract in strict accordance with the parties' contract and agreements therein, so long as the agreements do not violate statutory law, nor mandatory administrative and regulatory provisions. Art. 3. When adjudicating futures infringement of right disputes and invalid futures contract disputes, the people's courts shall determine the civil liabilities of the party at fault after an evaluation of the relative faults of the parties, the characteristics of the faults, the magnitude of the faults, and the causal relationship between the faults and loss suffered.") *Id.*

100. *See* 1986 GPCL, *supra* note 12.

101. He tong fa [Contract Law], (adopted by the Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999), available at [http://www.gov.cn/banshi/2005-07/11/content\\_13695.htm](http://www.gov.cn/banshi/2005-07/11/content_13695.htm) (last visited Mar. 20, 2009) (P.R.C.) (replacing the previous three separate contract laws, specifically, the 1981 Economic Contract Law, 1985 Economic Contract Law Involving Foreign Parties, & 1987 Technology Contract Law).

102. *See, e.g.*, Securities Law, *supra* note 59.

branches in local regions for securities firms and dealers.<sup>103</sup> Similarly, the China Futures Association (CFA), established in December 2000, is China's national futures self-regulatory association.<sup>104</sup> When it was formed, the SAC noted its functions and responsibilities would accord with relevant provisions of the Securities Law.<sup>105</sup> One of these functions and responsibilities is to mediate securities disputes between members, and between members and their clients.<sup>106</sup> The CFA has a similar role: one of its functions and responsibilities is to mediate disputes involving futures business amongst members, between members and their clients, and between certified brokers and their clients.<sup>107</sup> Currently, disputes amongst members or between members and their respective clients may be submitted to the CFA for mediation.<sup>108</sup>

Arbitration also plays an important role in futures trading regulation. In 2004, the Legal Affairs Office of the State Council and the CSRC jointly issued a notice on the arbitration of securities and futures contractual disputes (Securities and Futures Disputes Arbitration Notice).<sup>109</sup> The Securities and Futures Disputes Arbitration Notice promotes arbitration in securities contractual dispute resolution with an aim to make full use of the advantages of arbitration (expediency, flexibility, low cost and

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103. For discussion about the SAC, see SECURITIES REGULATION IN CHINA *supra* note 68, at 69–70.

104. The work to establish the China Futures Association started in 1995. Although the founders went through all the formalities and procedures for establishment, the work was stopped because of the government crackdown development of the futures market at that time. By the end of September 2003, the Association had 189 members located in 32 provinces and cities, including three Commodity Futures Exchanges as special members. See China Futures Association Home Page, <http://www.cfachina.org> (follow “About the Association” (“Xie hui jie shao”) hyperlink) (last visited May 18, 2009); see also SECURITIES REGULATION IN CHINA *supra* note 68, at 213 n.110.

105. See Zhong guo zheng quan ye xie hui zhang cheng [Articles of Association of the Sec. Ass'n of China], Art. 5, (adopted Jan. 22, 2007), available at [http://www.sac.net.cn/newen/home/info\\_detail.jsp?cate\\_id=1185524449100](http://www.sac.net.cn/newen/home/info_detail.jsp?cate_id=1185524449100) (P.R.C.) [hereinafter Articles of Association of the Sec. Ass'n of China].

106. See Articles of Association of the Sec. Ass'n of China, *supra* note 105, at Art. 5.

107. See Zhong guo qi huo ye xie hui zhang cheng [Articles of Association of the China Futures Ass'n], Art. 10, (adopted June 2, 2006), available at <http://www.cfachina.org/index.php?id=160> (last visited Apr. 24, 2009) (P.R.C.).

108. See Zhong guo qi huo ye xie hui hui yuan guan li zan xing ban fa [Provisional Measures on the Admin. of the Members of the China Futures Ass'n], Art. 16, (promulgated Dec. 29, 2000), available at <http://www.csrc.gov.cn/n575458/n4239016/n6634558/n9768113/10011976> (last visited Apr. 24, 2009) (P.R.C.).

109. See Guan yu yi fa zuo hao zheng quan, qi huo he tong jiu fen zhong cai gong zuo de tong zhi [The Notice on To Do Well in Accordance with Law the Work of Arbitration of Sec. & Futures Contract Disputes] (promulgated by the Legislative Affairs Office of the State Council and the China Sec. Regulatory Comm'n, Jan. 18, 2004), available at <http://www.csrc.gov.cn/n575458/n4239016/n6634558/n9768098/n9768420/9850707.html> (last visited Apr. 24, 2009) [hereinafter The Notice on To Do Well in Accordance with Law the Work of Arbitration of Sec. & Futures Contract Disputes].

confidentiality).<sup>110</sup> The two issues of greatest importance in the notice are the scope of arbitration in securities and futures contractual disputes, and the use of an arbitration clause in securities and futures contracts.<sup>111</sup> It stipulates a wide range of securities contractual disputes that fall into the scope of arbitration.<sup>112</sup> Furthermore, securities and futures model contracts are required to have an arbitration clause and parties have the right to choose an arbitration organization.<sup>113</sup>

#### IV. DEFINING FUTURES CONTRACTS

A complete understanding of the legal aspects of the commodity and financial futures trading market in China requires due consideration of the types of futures exchanges, futures contracts and futures disputes that exist in China, and the corresponding Chinese terminology. The enlarged scope of futures contracts under the 2007 Regulations indicates that the types of futures contracts and products permitted are increasingly comprehensive, as China's commodity and financial futures market develops and previous restrictive regulations are lifted.

In Chinese terminology, "futures" (*qihuo*) are divided into "commodity futures" (*shangpin qihuo*) and "financial futures" (*jinrong qihuo*). In the early years of China's futures market, when many futures exchanges existed, there were general types of commodity futures exchanges (*shangpin qihuo jiaoyisuo*) and special types of commodity futures exchanges, such as a

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110. See The Notice on To Do Well in Accordance with Law the Work of Arbitration of Sec. & Futures Contract Disputes, *supra* note 109 (citing such features of arbitration as special advantages in the resolution of securities contractual disputes through arbitration).

111. See The Notice on To Do Well in Accordance with Law the Work of Arbitration of Sec. & Futures Contract Disputes, *supra* note 109, at Points 1 & 2. Other issues addressed include the appointment of securities and futures professionals as arbitrators, the carrying out of the arbitration of securities and futures contractual disputes in accordance of law, and the supervision and guidance of the arbitration of securities and futures contractual disputes. See *id.* at Points 3, 4 & 5.

112. Those disputes include (1) disputes between securities issuers and securities companies or between securities companies arising from securities issuing and underwriting, (2) disputes between securities companies, futures broker firms, securities investment consultant organizations, futures investment consultant organizations and their clients arising from providing of services, (3) disputes between fund promoters, fund management companies and fund custodian organizations arising from fund issuing, management and custody, (4) disputes between accountant firms, law firms, asset and credit appraisal organizations and securities issuers, listed companies arising from providing of services, (5) disputes arising from change of shareholding in listed companies, securities companies, futures broker firms and fund management companies, (6) disputes between securities companies, securities investment consultant organizations, futures investment consultant organizations, futures broker firms, listed companies, fund management companies, registration and clearance organization and participants of securities and futures market arising from other contracts related to securities and futures trading. See The Notice on To Do Well in Accordance with Law the Work of Arbitration of Sec. & Futures Contract Disputes, *supra* note 109, at Point 1.

113. The Securities and Futures Disputes Arbitration Circular set June 30, 2004 as a deadline for securities and futures model contracts to have an arbitration clause. See The Notice on To Do Well in Accordance with Law the Work of Arbitration of Sec. & Futures Contract Disputes, *supra* note 109, at Point 2.

metal exchange (*jinshu jiaoyisuo*) and a grain & oil exchange (*liangyou shangpin jiaoyisuo*).<sup>114</sup> Before the government suspended trading of financial futures in the middle of the 1990s, there were government bond futures (*guozhai qihuo*), foreign exchange futures (*waihui qihuo*), and foreign exchange cash deposit transactions (*waihui anjin jiaoyi*).<sup>115</sup> In the early 1990s, if a Chinese futures brokerage firm operated jointly with a foreign futures broker outside China, share index futures (*guzhi qihuo*) and other financial futures products were also available to investors.<sup>116</sup> Futures trading disputes also included sub-categories. Futures disputes were sometimes classified into two general groups: those connected with the trading of futures contracts (*heyue jiaoyi jiufen*) and those connected with the settlement of physical commodities (*shiwu jiaoge jiufen*).<sup>117</sup> This classification reflected different stages of futures trading, each with different legal issues.

In the 1999 Provisional Regulations, a “futures contract” (*qihuo heyue*) was defined as a standard contract formulated by futures exchanges that stipulates for deliveries of commodities of a certain quantity and quality at a certain time and place in the future.<sup>118</sup> This definition has essentially remained the same in the 2007 Regulations,<sup>119</sup> although the scope of futures contracts has been enlarged to add financial futures contracts (*jinrong qihuo*

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114. For example, the Shanghai Metal Exchange and the Shanghai Grain & Oil Exchange.

115. The government bond futures market emerged in early 1993 with trading on the Shanghai Stock Exchange, and later, in some commodity and securities exchanges in Beijing and Wuhan. In May 1995, the trading of government bond futures was suspended by the government. See The Urgent Notice on Suspension of Trials of Gov't Bond Futures Trading, *supra* note 30. Transactions involving foreign exchange futures and foreign exchange cash deposits, which appeared in early 1990s, were banned by the government in December 1994. See The Notice on Relevant Issues about Cancellation by Futures Broker Firms of Offshore Futures Bus., *supra* note 31.

116. For example, in *Qingyuan City Overseas Chinese Commodity Co. v. Qingyuan City Tongye Int'l Futures Trading Firm*, various commodity and financial futures products on the Chicago Mercantile Exchange, including Standard & Poor's 500 Index futures, were available to the plaintiff investors. See EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 241 (discussing *Qingyuan City Overseas Chinese Commodity Co. v. Qingyuan City Tongye Int'l Futures Trading Firm*); see also discussion *infra* Part IX.

117. See UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 321.

118. Article 70 (2) states that “‘futures contract’ refers to a standard contract formulated uniformly by futures exchanges which stipulates for delivery of a commodity of a certain quantity and quality at a certain time and place in the future.” The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 70 (2).

119. Article 85 (1) states that “Futures contract (*qihuo heyue*) refers to a standard contract uniformly formulated by futures exchange which stipulates for deliveries of a thing of a certain quantity at a certain time and place in the future. According to the different things involved in a contract, futures contract is divided into commodity futures contract and financial futures contract. The objects of commodity futures contracts include agriculture products, industrial products, energy and other commodities and associated index products; the objects of financial futures contracts include financial products like securities, interest rate, exchange rate and so on and associated index products.” See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 85 (1).

heyue).<sup>120</sup> This expanded definition was a result of the establishment of the CFFEX and the introduction of financial futures products in 2006.<sup>121</sup> In addition, an “option contract” (*qiquan heyue*) was introduced in the 2007 Regulations.<sup>122</sup> This addition helped increase liquidity and stability of China’s futures market by providing a means for risk management of futures trading.<sup>123</sup> The 2007 Regulations thereby further paved a regulatory way for the future development of China’s financial futures market through the clarification and standardization of industry terminology.

## V. ENGAGING IN FUTURES TRADING

Engaging in futures trading involves two issues: first, where the futures trading should be conducted, and second, who should be allowed to engage in futures trading and in what manner. The 1999 Provisional Regulations required that futures trading be conducted in a futures exchange, the establishment of which required approval by the CSRC.<sup>124</sup> Before these regulations, futures exchanges were established upon approval by local government. Because a futures exchange may be either a plaintiff or a defendant in a dispute, and because the early futures market was a mix of futures exchanges with and without proper approvals, the people’s courts examined the propriety of local government approval before considering other issues of the dispute. As a threshold matter, the people’s courts assessed whether the futures exchange was established and functioned in accordance with and under the approval of regulators.

In *Shanghai Foreign Trade Company v. Shanghai Chemicals Commodity Exchange*,<sup>125</sup> the defendant Shanghai Chemical Commodity Exchange was a state-owned enterprise established upon approval of the Administrative Bureau of Industry and Commerce of Shanghai Municipality, whose services were to provide for a chemical commodity trading place and facilities to deal with clearance and transfers, and to

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120. The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 85 (1).

121. The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 85 (1).

122. Article 85 (2) states that “Option contract (*qiquan heyue*) refers to a standard contract uniformly formulated by futures exchange which stipulates that buyer has right to purchase or sell an object agreed upon (including futures contracts) at a certain time and a specified price in the futures.” See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at 85 (2).

123. For a discussion on the option contract (*qiquan heyue*) and its function in risk management, see Gao Yongshen & Quan Liping, *Qi quan he yue ji qi zai feng xian guan li zhong de ying yong* [Option Contract and its Application in Risk Management], at 17–19, *Jiangsu Commercial Forum*, Jiangsu Shanglun, Issue 11, 1998, available at <http://lsk.cnki.net/kns50/detail.aspx?QueryID=15&CurRec=6>.

124. The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 4, Art. 6.

125. See *Shanghai Foreign Trade Co. v. Shanghai Chem. Commodity Exch.*, in *Ren min fa yuan an li xuan Jing bian ben* [SUPREME PEOPLE’S COURT & CHINA RESEARCH INST. OF APPLIED SCIENCE OF LAW, AN ESSENTIAL SELECTION OF CASES OF THE PEOPLE’S COURTS] 763–69 (Beijing: Xinhua Publishing House, vol. 1, 2001).

provide other services relating to the chemical commodity trading.<sup>126</sup> Because one of the Administrative Bureau of Industry and Commerce of Shanghai Municipality's functions was to approve and register business entities, the Shanghai Changning District People's Court was satisfied that the defendant had been established under the appropriate governmental approvals and registration procedures applicable at that time.<sup>127</sup>

Likewise, in *Hainan Zhongqing Jiye Development Centre v. Sichuan Pingyuan Industrial Development Co.*,<sup>128</sup> the Hainan Zhongshang Futures Exchange, which provided members with a trading place for natural rubber and other futures contracts, was established upon approval of the CSRC and issuance of an enterprise legal person business license by the Administration for Industry and Commerce.<sup>129</sup> There, the Sichuan High People's Court was satisfied that the exchange had obtained proper approval and business license.<sup>130</sup> The people's courts were compelled to scrutinize the status of China's early futures exchanges due to the different kinds of local futures exchanges which had come into operation like mushrooms during the hectic expansion of China's futures market; however, such sharp scrutiny became less important after 1998, when only three futures exchanges remained nationwide.

The people's courts also examined futures broker firms to determine whether they were authorized dealers. According to the 1999 Provisional Regulations, a futures broker firm must become a member of a futures exchange to trade futures contracts on behalf of its clients<sup>131</sup> and must be approved by the CSRC and registered with the Administration for Industry and Commerce.<sup>132</sup> Financial institutions, state organizations, other state institutions and individuals are not allowed to trade futures contracts otherwise, and conversely, a futures broker firm may not accept futures contracts and act for them.<sup>133</sup> Courts presented with the issue of futures trading by non-members of a futures exchange have enforced such requirements.

In *Zhongyuan Grain & Oil Trading Co. v. Zhumadian Region Yinfeng Co.*,<sup>134</sup> the two defendants acting as brokers for futures trading were not

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126. See *Shanghai Foreign Trade Co.*, at 765.

127. See *id.*

128. See *Hainan Zhongqing Jiye Dev. Ctr. v. Sichuan Pingyuan Indus. Dev. Co.*, in the Gazette of the Supreme People's Court, issue 4, 2005, at 25–30 (P.R.C.).

129. See *Hainan Zhongqing Jiye Dev. Ctr.*, at 27.

130. See *id.* at 27.

131. The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 28.

132. The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 22.

133. The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 30. An unprofitable enterprise, for instance, is not allowed to involve in futures trading. See *id.*

134. See *Zhongyuan Grain & Oil Trading Co. v. Zhumadian Region Yinfeng Co.* in Ren min fa yuan an li xuan Jing bian ben [SUPREME PEOPLE'S COURT & CHINA RESEARCH INST. OF APPLIED



members of the Zhengzhou City Grain Commodity Exchange, nor had they been approved by the CSRC and registered with the Administration for Industry and Commerce to engage in futures business. The Court also found that the plaintiff was a loss-making enterprise at the time it entrusted the defendants to trade futures contracts.<sup>135</sup> Government regulatory policy prohibited a loss-making enterprise from being involved in speculative futures trading,<sup>136</sup> so the Court annulled the brokerage agreement signed between the parties.<sup>137</sup>

In *Suzhou Foreign Trade Commodity Holding Co. v. Zhejiang Huanya Industrial Co.*,<sup>138</sup> the Supreme People's Court affirmed that the two futures trading contracts signed between the plaintiff and defendant were invalid because the plaintiff lacked authorization to engage in the futures brokerage business. The plaintiff was a member of the Suzhou Commodity Exchange and was approved to engage in futures trading, but only on the plaintiff's own account and not as a broker trading on behalf of others.<sup>139</sup> Furthermore, the contracts were formed with the illegal intent to jointly manipulate market prices.<sup>140</sup> This additional finding furthered the court's decision to annul the contracts.

An important question present in these cases is who should bear the clients' losses. One consideration is that the broker firm should bear the burden, when, under the regulations, their acts are invalid; however, this reasoning was not consistently supported prior to the 1995 SPC Futures Judicial Guidelines. In the majority of cases, the people's courts ruled in favor of the clients, requiring the broker firms return lost deposits to the clients. However, this approach was criticized by commentators who argued that the people's courts misunderstood the legal relationship between the brokerage firm and its clients in futures trading.<sup>141</sup> Commentators argued that such a relationship was neither an ordinary agency relationship (*daili guanxi*), nor an intermediation relationship (*jujian guanxi*); rather, it was a commission agency relationship (*hangji guanxi*).<sup>142</sup> Under a commission agency relationship, the basic obligation of a futures broker firm was

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SCIENCE OF LAW, AN ESSENTIAL SELECTION OF CASES OF THE PEOPLE'S COURTS] 769–77 (Beijing: Xinhua Publishing House, vol. 1, 2001).

135. *Zhongyuan Grain & Oil Trading Co.*, at 769–77.

136. See The Notice of the Gen. Office of the St. Council Seeking Instructions on Several Opinions on Firmly Stopping Blind Dev. of the Futures Mkt., *supra* note 4, at Point 4.

137. See *Zhongyuan Grain & Oil Trading Co.*, at 771.

138. See UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 263–95.

139. See *id.* at 263–95.

140. See *id.* at 273, 288.

141. See Jin rong fa dian xing an li jie xi, di yi ji [EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW] 247–48 (Wu Zhipan & Tang Jiemang et al. eds., China Finance Publishing House Vol. 1, 2000) [hereinafter EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW].

142. *Id.* at 247.

merely to execute the trading instructions of clients truthfully, and therefore the broker firm would not bear legal responsibilities for the consequences of normal trading;<sup>143</sup> if a futures broker firm's actions were rendered invalid because the firm lacked the necessary qualification, then only the broker firm's commissions would be considered damages.<sup>144</sup>

The 1995 SPC Futures Judicial Guidelines addressed the apparent ambiguity. First, the people's court should establish whether there is a causal link between the losses suffered by the clients and the invalid acts of broker firms.<sup>145</sup> If a broker firm is not qualified to engage in futures trading, but acts for its clients, then the broker firm should not be liable for losses if evidence proves that the broker firm carried out the trading according to the instructions of the client;<sup>146</sup> the loss suffered by the client under those circumstances will be due to normal market risks.<sup>147</sup> Although a broker firm will have carried out invalid trading activities, it should not bear the client's loss if there is no direct link between the invalid trading and the loss. This reasoning resonates within the more recent 2003 SPC Futures Judicial Provisions.<sup>148</sup>

*Zhongyuan Grain & Oil Trading Co. v. Zhumadian Region Yinfeng Co.*,<sup>149</sup> affirmed that a futures broker firm will not be liable for the loss suffered by a client if there is no direct link between the invalid trading and the loss. In that case, the Court annulled the brokerage agreement signed between the parties because the two defendants were not qualified to engage in futures trading, and additionally, the plaintiff was a loss-making enterprise and was prohibited from trading commodity futures contracts.<sup>150</sup> The Court distinguished between losses suffered as a result of trading carried out in accordance with the plaintiff's instructions and losses suffered as a result of trading carried out without the plaintiff's instructions.<sup>151</sup> The Court rejected the plaintiff's claim but held the defendant liable for the

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143. *Id.*

144. However, it was also submitted that the firm's commissions should be confiscated rather than returned to the client if the client's involvement in futures trading was illegal. *Id.* at 248.

145. The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 7.

146. The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 7.

147. The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 7.

148. Article 14 states that "where a client's economic loss is caused by invalid futures contracts, the responsibilities should be determined and borne according to the causal link between the invalid acts and the loss. If one party's loss is caused by the act of the other party, the other party should compensate the loss; if both parties are at fault each of them should bear corresponding civil responsibility according to the portion of the fault." The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 14.

149. See *Zhongyuan Grain & Oil Trading Co. v. Zhumadian Region Yinfeng Co.*, in *Ren min fa yuan an li xuan Jing bian ben* [SUPREME PEOPLE'S COURT & CHINA RESEARCH INST. OF APPLIED SCIENCE OF LAW, AN ESSENTIAL SELECTION OF CASES OF THE PEOPLE'S COURTS] (Beijing: Xinhua Publishing House, vol. 1, 2001).

150. See *Zhongyuan Grain & Oil Trading Co.*, at 771.

151. *Id.* at 771-72.

losses related to trading that was outside of the plaintiff's instructions.<sup>152</sup> The ruling was upheld on appeal in the Henan High People's Court.<sup>153</sup>

In addition, if a futures broker firm oversteps its approved business scope (*jingying fanwei*), any relevant contracts are deemed null and void. For example, in *Liang Jintao v. Baishigao Futures Consultant Serv. Co.*,<sup>154</sup> defendant Baishigao was a joint venture whose registered business scope included consulting, training and services relating to commodity futures trading. Baishigao signed an agreement with plaintiff Liang Jintao, stipulating that Liang Jintao would open an account at Baishigao and that Baishigao would act as Liang Jintao's broker for trading commodity futures.<sup>155</sup> Liang Jintao deposited 250,000 *yuan* into the account, but after experiencing a loss, Liang Jintao discovered that Baishigao had used the account funds for futures trading without his instructions.<sup>156</sup> The Administration for Industry and Commerce of Shenzhen City issued a notice to Baishigao requiring it to cease trading commodity futures, an activity not included in Baishigao's registered business scope.<sup>157</sup>

Upon demand, Baishigao returned only 50,000 *yuan* to Liang Jintao, who decided to sue in the Luohu District Court of Shenzhen City.<sup>158</sup> The Court held the parties' agreement null and void on the grounds that the defendant had overstepped its business scope.<sup>159</sup> Because the defendant had acted without the plaintiff's instructions, the Court held that the defendant must return the remaining balance of 200,000 *yuan* to the plaintiff,<sup>160</sup> in accordance with Article 7 and Article 16 of the Economic Contract Law.<sup>161</sup>

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152. *Id.* at 772.

153. *Id.* at 774. The defendant appealed the case on the ground of their argument that they had acted for the plaintiff until May 26, 1995, not March 23, 1995, as the plaintiff submitted. A substantial part of the losses suffered by the plaintiff was caused by the transactions carried out by the defendant in April and May 1995. The plaintiff submitted that they had not given the defendant any further instructions after May 23, 1995. The Court of first instance ruled that March 23, 1995 was the last day the plaintiff had instructed the defendant; the transactions in April and May were carried out by the defendant without the plaintiff's instructions; and the Court held the defendant liable for the losses caused by the transactions in April and May. The Henan High People's Court upheld the ruling of the Court of first instance, although the Henan High People's Court determined that the plaintiff had given the defendant instructions until March 31, 1995. *See id.*

154. *See Liang Jintao v. Baishigao Futures Consultant Serv. Co.*, in *Guang dong shen pan an li [ADJUDICATED CASES OF GUANGDONG]* 346-49 (Guangdong High People's Ct. Research Dept. eds., Guangdong People's Publishing House, 1997).

155. *Id.* at 346.

156. *Id.*

157. *Id.* at 347.

158. *Id.*

159. *Id.*

160. *Liang Jintao*, at 347.

161. Article 7 (1) and (2) of the 1981 Economic Contract Law, as amended in 1993, states that "the following economic contracts shall be void: (1) contracts violating the law or state policies and plans; (2) contracts signed by means of fraud, coercion or similar means." Article 16 states that "after an economic contract has been determined to be void, the property that the party has obtained in accordance with the contract shall be returned to the other party. The party who is at

So long as a futures broker firm strictly carried out its client's trading instructions, the firm would not be held liable for any loss suffered as a result of such a trading instruction.<sup>162</sup> In this case, however, the defendant was correctly held liable for returning the lost deposit to the plaintiff because the defendant traded without plaintiff's instructions and thus directly caused the losses.<sup>163</sup> The Shenzhen Intermediate People's Court affirmed the reasoning which placed the legal consequences on the defendant that had carried out futures trading without the plaintiff's instructions.<sup>164</sup>

The regulation of futures exchanges and futures broker firms has moved towards a more balanced regulation and supervision, a marked improvement since 1999. The current regulations for establishing and operating futures exchanges restate the basic regulatory positions of the 1999 Provisional Regulations. Both the 2007 Regulations and the 2007 Measures on the Administration of Futures Exchange require CRSC approval in order to establish a futures exchange.<sup>165</sup> The futures exchange must also indicate whether it is a "commodity exchange" or "futures exchange" in its name, and no other organization or individual may use the same name.<sup>166</sup> Further, any organization or individual that illegally

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fault shall compensate for the loss the other party has suffered as a result; if both parties are at fault, each of them shall bear corresponding responsibilities..In the case of an economic contract which violates the interest of the state and the public interest, if both parties have acted wilfully, the property that they have obtained or are due to obtain by mutual agreement shall be recovered and turned over to the State Treasury. If only one party has acted wilfully, the wilful party shall restore to the other party the property it has obtained from the latter; the party that party that has not acted wilfully shall turn over to the State Treasury any property it has obtained from the other party or is due to obtain by mutual agreement." Zhong hua ren min gong he guo jing ji he tong fa [Economic Contract Law] Art. 7 (1), (2), (promulgated by Standing Comm. Nat'l People's Cong., Dec. 13, 1981, effective July 1, 1982, revised Sept. 2, 1993), (repealed and replaced by Zhong hua ren min gong he guo he tong fa [Contract Law] (promulgated by Nat'l People's Cong., Mar. 15, 1999, effective Oct. 1, 1999)), *available at* <http://www.court.gov.cn/lawdata/law/civil/200807310033.htm> (last visited May 18, 2009), (P.R.C.) [hereinafter 1981 Economic Contract Law].

162. See Liang Jintao v. Baishigao Futures Consultant Serv. Co., in *Guang dong shen pan an li* [ADJUDICATED CASES OF GUANGDONG] 349 (Guangdong High People's Ct. Research Dept. eds., Guangdong People's Publishing House, 1997).

163. See *Liang Jintao*, at 349.

164. See *id.* at 348. The defendant appealed the case, arguing that there was an error in the finding of the facts by the Court of first instance; the issue of the firm's overstep of its business scope, upon which the Court made the judgment, was still pending a review decision after the defendant had applied for a review to the Guangdong Administration of Industry and Commerce; and the judgement was made without sufficient evidence.. The Shenzhen Intermediate People's Court rejected the defendant's appeal and ruled that the facts of the case were clearly judged by the Court of first instance. The Shenzhen Intermediate People's Court also said that the defendant should bear the legal consequences for the futures trading carried out by the individual broker of the defendant without the plaintiff's instructions. See *id.*

165. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 6; The 2007 Measures on the Admin. of Futures Exch., *supra* note 38, at Art. 6.

166. The 2007 Measures on the Admin. of Futures Exch., *supra* note 38, at Art. 7.

establishes a futures exchange is subject to sanction.<sup>167</sup> On the other hand, the 2007 Regulations are flexible by allowing futures trading in other trading places approved by futures regulators, in addition to formal futures exchanges where futures trading is normally conducted.<sup>168</sup> In this context, the 2007 Regulations emphasize a prohibition on trading outside an authorized futures trading place.<sup>169</sup>

The 2007 Regulations also made noticeable changes regarding the regulation of futures companies and their business. The 2007 Regulations called for a licensing system that recognized which futures companies may engage in a wider range of futures brokerage business, including commodity futures, financial futures, futures consultancy business, and offshore futures.<sup>170</sup> Under the 2007 Regulations, the minimum amount of registered capital required to establish a futures company is thirty million *yuan*, which is the same requirement under the 1999 Provisional Regulations; however, the 2007 Regulations give futures regulators discretion to raise the minimum registered capital based on prudential principles and according to the risk levels of the specific futures business.<sup>171</sup> Other areas of improvement are the corporate governance of futures companies and the protection of clients' money.<sup>172</sup> The regulation of futures companies is now clearer and in better shape: it balances the future regulators' needs for proper control of the market with the futures companies' needs for growth and engagement in a wider range of futures business.

## VI. CARRYING OUT THE CLIENT'S INSTRUCTIONS AND THE BURDEN OF PROOF

A futures broker firms' faithfulness in carrying out a client's instructions has historically been a matter of significant dispute. During the early years of China's futures market, clients claimed losses on the grounds that the futures broker firm failed to carry out their instructions genuinely. A prime example is *Wang Huiwen v. Zhuhai City Xinguang Futures*

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167. According to Article 78, such a futures exchange will be closed down; illegal gains will be confiscated and a fine will be paid equivalent to one to five times of the illegal gains; those who have direct responsibilities will be subject to a warning and a fine between 10,000 to 100,000 *yuan*. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 78.

168. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 4, 88.

169. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 4.

170. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 17.

171. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 16.

172. Chapter 3 (arts. 33–47) and Chapter 5 (arts. 69–76) of the 2007 Measures on the Administration of Futures Company deal with corporate governance of futures company and protection of clients' assets respectively. In contrast, the 2002 Measures on the Administration of Futures Broker Firms have no specific concentrated chapters apart from some individual articles which deal with the issue of corporate governance and protection of clients' assets. See The Measures on the Admin. of Futures Co., *supra* note 66, at ch. 3, Arts. 33–47, ch. 5, Arts. 69–76.

*Brokerage Co. Ltd.*,<sup>173</sup> a 1995 case where the parties signed an agreement that Wang Huiwen would open an account and deposit 500,000 *yuan* and Xinguang would act as his agent in trading domestic and international commodity and financial futures, options and spot trading products.<sup>174</sup> Between October 16 and October 24, 1995, Wang Huiwen instructed Xinguang to sell 1800 lots of Shanghai 95.11 glue board futures at the Shanghai Commodity Exchange.<sup>175</sup> After a loss of 1,186,800 *yuan*, Wang Huiwen sued Xinguang in the Intermediate People's Court of Zhuhai City, claiming that the defendant failed to execute his instructions.<sup>176</sup>

The Court found that defendant failed to show that the company had correctly executed plaintiff's instructions; the evidence of the deal price conflicted with the Shanghai Commodity Exchange records.<sup>177</sup> This was enough for the Court to infer that the defendant failed to trade under the plaintiff's instructions.<sup>178</sup> Following Article 61 of the 1986 GPCL,<sup>179</sup> the Court required the defendant to return 1,186,000 *yuan* and 54,000 *yuan* in commission charges and applicable interests, respectively.<sup>180</sup>

The defendant appealed in the Guangdong High People's Court, arguing that the evidentiary problems were caused by the common business practices of "first in, first out" (*xianru, xianchu*) and "mixed position operation" (*huncang caozuo*).<sup>181</sup> These practices were the custom and usage followed by many futures companies as a matter of convenience, administrative efficiency and cost effectiveness. However, the Guangdong High People's Court stated that the rules of the Shanghai Commodity Exchange should be the standard by which to judge whether a certain business practice breaches trading rules because that exchange was the ultimate trading place.<sup>182</sup> Since the industry practices of "first in, first out" and "mixed position operation" violated the rules of the Shanghai Commodity Exchange, the Court held that the defendant could not justify its own practices by arguing that they were common and normal practices in the futures business.<sup>183</sup>

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173. See Wang Huiwen v. Zhuhai City Xinguang Futures Brokerage Co., in the Gazette of the Supreme People's Court, issue 1, 1999, at 29–30 (P.R.C.).

174. See Wang Huiwen, at 29–30.

175. See *id.*

176. See *id.*

177. See *id.*

178. See *id.*

179. Article 61 of the 1986 GPCL states, "[a]fter a civil act has been adjudged void or has been rescinded, the party who had acquired property as a result of such act shall return it to the party who suffered the loss. The party at fault shall compensate the other party for the losses it suffered as a result of such act; if both parties are at fault, each party shall assume responsibility corresponding to their share of fault." 1986 GPCL, *supra* note 12, at Art. 61.

180. See Wang Huiwen v. Zhuhai City Xinguang Futures Brokerage Co., in the Gazette of the Supreme People's Court, issue 1, 1999, at 29–30 (P.R.C.).

181. See Wang Huiwen, at 29–30.

182. *Id.* at 30.

183. *Id.*

*Wang Huiwen* shows that evidence plays a central role in determining whether a given instruction from a client was genuinely executed by a futures broker firm. The general evidentiary rule is that claimants shall discharge the burden of proof (*shui zhuzhang, shui juzheng*);<sup>184</sup> however, a defendant broker firm typically would bear the burden of proof under the 1995 SPC Futures Judicial Guidelines if a client claimed the firm did not conduct trading in the market.<sup>185</sup> *Wang Huiwen* was correctly decided along the Supreme People's Court direction, as prescribed in the 1995 SPC Futures Judicial Guidelines; that is, when clients suspect that the broker firm failed to trade on the market according to their instructions, the broker firm shall bear the burden of proof.<sup>186</sup>

The 2003 SPC Futures Judicial Provisions refined the 1995 SPC Futures Judicial Guidelines' treatment of the burden of proof where the issue is whether a futures broker firm failed to carry out a client's trading instruction. Under Article 56 of the 2003 SPC Futures Judicial Provisions, a futures broker firm bears the burden.<sup>187</sup> However, if a client has evidence proving his trading instruction was not executed on the market, the people's court must examine the futures exchange trading records and the firm trading settlement notifications to determine whether records match the client's instructions for the product, the direction of trading, the price of trading and the trading time; in addition, the court may also look to the quantity of the trading instructed.<sup>188</sup>

In general, the 2003 SPC Futures Judicial Provisions apply only to causes of action that accrue after July 1, 2003, but in accordance with Article 63, the 2003 SPC Futures Judicial Provisions may apply to a cause of action that accrued before that date if there are no other clear and definite provisions that apply.<sup>189</sup> Once a case is closed and takes legal effect, however, it may not be retried by reference to the 2003 SPC Futures Judicial Provisions.<sup>190</sup>

For example, in *Chen Zhongyi v. Tianyi Futures Brokerage Co. Ltd.* the parties signed a futures brokerage contract, whereby Chen Zhongyi entrusted broker Tianyi to carry out futures trading while Chen Zhongyi

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184. See 1991 Civil Procedure Law, *supra* note 11, at Art. 64.

185. The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 9.

186. See *Wang Huiwen v. Zhuhai City Xinguang Futures Brokerage Co.*, in *Gazette of the Supreme People's Court*, issue 1, 1999, at 30 (P.R.C.).

187. Article 56 (1) of the 2003 SPC Futures Judicial Provisions states that a "[f]utures company should bear the burden of proof as to whether the client's trading order has been executed on the market." See The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 56 (1).

188. The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 56 (2).

189. Under Article 63, the 2003 SPC Futures Judicial Provisions do not apply retroactively. However, if an ambiguity exists in a cause of action that arises before July 1, 2003, the court may look to the provisions for guidance. See The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 63.

190. See The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 63.

bore the associated risks.<sup>191</sup> Chen Zhongyi opened an account at Tianyi, was assigned a unique client code, and then instructed Tianyi to purchase twenty lots of November soybean at a total price of 441,800 *yuan*.<sup>192</sup> When the value decreased by 41,800 *yuan*, Chen Zhongyi sued Tianyi in the Intermediate People's Court of Chengdu, Sichuan, claiming the decrease of 41,800 *yuan* in damages and demanding return of the 600 *yuan* commission charged by the defendant for the transactions.<sup>193</sup> The court's examination of the Dalian Commodity Exchange records revealed five transactions made with Chen Zhongyi's unique client code on that date. Three of the transactions matched the plaintiff's instructions in product, quantity, price and time of the deal, but the plaintiff had instructed only one purchase. The Court recognized that the defendant had conducted "mixed code trading" (*hunma jiaoyi*), that is, trading whereby a common code is shared by several clients.<sup>194</sup> Under this mixed code trading practice, it was inevitable that a client's own code would not be the same as the code used in trading.<sup>195</sup>

The issue was whether one of the three transactions carried out by the defendant was the plaintiff's instructed transaction. Since the 1995 SPC Futures Judicial Guidelines lacked criterion by which the people's court could determine whether a futures broker firm carried out a client's trading instruction, the Court referred to Article 56 of the 2003 SPC Futures Judicial Provisions for guidance.<sup>196</sup> The Court said that because the Dalian Commodity Exchange's trading records matched the defendant's trading settlement notifications and the plaintiff's instruction in terms of product, the direction of trading, the price of trading, the trading time and the quantity of the trading, it should therefore be determined that the defendant had executed the plaintiff's instruction on the market.<sup>197</sup> Although the plaintiff submitted that the defendant had not conducted a mixed code trading but had used others' trading results as the plaintiff's, because the plaintiff had not adduced opposite evidence to prove the submission, the plaintiff's submission could not be supported.<sup>198</sup> The Intermediate People's Court of Chengdu then rejected the plaintiff's claim.<sup>199</sup>

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191. See *Qi huo su song yuan li yu pan li* [PRINCIPLES AND PRECEDENTS OF FUTURES LITIGATION] 374–80 (Wu Qingbao et al. eds., Beijing: the People's Court Publishing House, 2005) (discussing *Chen Zhongyi v. Tianyi Futures Brokerage Co.*) [hereinafter *PRINCIPLES AND PRECEDENTS OF FUTURES LITIGATION*].

192. *Id.* at 375.

193. *Id.*

194. *See id.*

195. *See id.*

196. *Id.* at 376.

197. *See* *PRINCIPLES AND PRECEDENTS OF FUTURES LITIGATION*, *supra* note 191, at 376.

198. *Id.*

199. *Id.*



On appeal by the plaintiff in the Sichuan High People's Court, both the ruling and reasoning were upheld.<sup>200</sup> According to at least one commentator, both the instant and appeal courts in this case made correct judgments in accordance with the evidential criterion set out by Article 56 of the 2003 SPC Futures Judicial Provisions.<sup>201</sup> Although the plaintiff claimed that her instruction had not been executed on the market on June 9, 2000, no definite evidence was adduced to prove this submission.<sup>202</sup> Therefore, the burden of proof assumed by the plaintiff had not been met.<sup>203</sup> While the plaintiff claimed that the defendant had not executed her instruction and used others' trading results to prove it had executed her instruction, such claims could not be proven<sup>204</sup>

In the vein of the 1999 Provisional Regulations, the 2007 Regulations reiterate that securities companies shall neither carry-out futures trading without clients' instruction nor fail to accord to clients' instruction.<sup>205</sup> Clients may give futures companies trading orders in writing, by telephone, or via internet, but their orders must be clear and complete.<sup>206</sup> If futures companies carry out futures trading without their clients' instructions or fail to follow their clients' instructions, or if futures companies fail to execute clients' instructions in futures exchanges, then futures companies are subject to a combined regulatory sanction of caution by a regulatory body, confiscation of illegal gains and a fine of one to three times the illegal gains.<sup>207</sup> In serious cases, businesses will be suspended or their licences will be revoked.<sup>208</sup>

## VII. FORCED LIQUIDATION BY A FUTURES EXCHANGE OR FUTURES BROKER FIRM

Disputes often arise regarding losses occurring after a forced liquidation. "Forced liquidation" (*qiangzhi pingcang*) refers to a forced measure taken by a futures exchange or a futures brokerage firm to close out the positions held by the firm or a client of the firm when the required margin falls and the firm or the client fails to gain additional margin on time, as set out in the trading rules of the futures exchange or by the applicable futures brokerage

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200. *Id.* at 378.

201. *See id.* at 379–80 (discussing *Chen Zhongyi v. Tianyi Futures Brokerage Co.*) (commenting that since the 1995 SPC Futures Judicial Guidelines had no clear provisions regarding the burden of proof under such circumstances, the Court was right to deal with the issue by reference to Article 56 of the 2003 SPC Futures Judicial Provisions.)

202. *Id.* at 380.

203. PRINCIPLES AND PRECEDENTS OF FUTURES LITIGATION *supra* note 191, at 380.

204. *Id.*

205. The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 25.

206. The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 27.

207. The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 70.

208. *See* The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 71.

contract.<sup>209</sup> The nature of the dispute is whether the forced liquidation measure is a right or an obligation of futures exchanges or futures broker firms, and also who should bear the losses. Three views have emerged on whether the forced liquidation is a right or an obligation of futures exchanges or futures broker firms.<sup>210</sup>

The first view regards forced liquidation as a right exercisable by futures exchanges or futures broker firms.<sup>211</sup> Currently, there is no provision in Chinese law or regulation that defines forced liquidation as a right or an obligation of futures exchanges or futures broker firms.<sup>212</sup> Therefore, the characterization should be based on trading rules of futures exchanges and the brokerage agreements between futures broker firms and their clients.<sup>213</sup> Futures exchanges regard forced liquidation in their trading rules as a right, while agreements between futures broker firms and their clients generally stipulate that the futures broker firm has the right to close out the positions of a client if the client fails to make additional margin as required.<sup>214</sup>

The second view regards the forced liquidation as both a right and an obligation of the broker firm.<sup>215</sup> As far as futures broker firms are concerned, the fulfilment of such an obligation is more important.<sup>216</sup> Since forced liquidation prevents a client's unfavorable market situation from worsening, it is a necessary protective measure.<sup>217</sup> In this view, the futures broker firms have an obligation to protect their clients.<sup>218</sup>

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209. See *Summary of Shanghai Seminars on Handling Futures Trading Disputes*, *supra* note 7, at 229. In accordance with Article 41 of the 1999 Provisional Regulations and Article 36 of the 2003 SPC Futures Judicial Provisions, where the amount of margin of a member of a futures exchange falls below the required level, the member must provide additional margin within the time limit set out in the trading rules of the futures exchange; where the amount of margin of a client of a futures broker firm falls below the required level, the client must provide additional margin within the time limit set out by the futures brokerage contract. See The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 41; The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 36.

210. These three views have been acknowledged and discussed by various authors. See EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 253–54; see also Shang shi shen pan shi wu nan dian jing jie [ESSENTIAL EXPLANATIONS OF DIFFICULT ISSUES IN THE PRACTICE OF COMMERCIAL ADJUDICATION] 277–81 (Wu Qingbao ed., Beijing: the People's Court Publishing House, 2003) [hereinafter ESSENTIAL EXPLANATIONS OF DIFFICULT ISSUES IN THE PRACTICE OF COMMERCIAL ADJUDICATION]; *The Summary of Shanghai Seminars on Handling Futures Trading Disputes*, *supra* note 7, at 229.

211. EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 253.

212. *Id.*

213. *Id.*

214. *Id.* at 253–54.

215. *Id.* at 254.

216. *Id.*

217. EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 254.

218. *Id.*

The third view regards forced liquidation as a right during the initial stages of margin call, which is then later transformed to an obligation.<sup>219</sup> The futures exchange or futures broker firm generally marks two points of time in its trading rules or agreements: the time at which an additional margin must be made, and the time at which the futures exchange or futures broker firm must close out positions, if the additional margin has not been made, in order to mitigate further losses.<sup>220</sup> At the time when the additional margin is not made, the futures exchange or futures broker firm acquires the right to close out the positions, but may not exercise such a right at this stage.<sup>221</sup> With further losses, the futures exchange or futures broker firm must fulfil its obligation of a forced liquidation, whereby failure to act would render them liable for any subsequent losses.<sup>222</sup>

Some contemplate a mix of the second and third view by regarding forced liquidation as having a dual nature.<sup>223</sup> In the legal relationships between a futures exchange and a futures broker firm, and between a futures broker firm and its clients, a forced liquidation is a contractual right exercisable by the futures exchange or the futures broker firm.<sup>224</sup> On the other hand, a futures exchange and futures broker firm are required, under relevant regulations and the provisions of trading rules, to liquidate a position when the amount of margin falls below a required level.<sup>225</sup> A forced liquidation is thus an obligation from a market regulation point of view.<sup>226</sup> If a futures exchange or futures broker firm fails this obligation, it bears the responsibilities and consequences for allowing trading with overdraft.<sup>227</sup>

The 1995 SPC Futures Judicial Guidelines, the 1999 Provisional Regulations and the 2003 SPC Futures Judicial Provisions all have provisions regarding forced liquidation.<sup>228</sup> In each provision, different words are used in prescribing forced liquidation by futures exchanges or futures broker firms. The 1995 SPC Futures Judicial Guidelines use the word “may” (*keyi*),<sup>229</sup> while the 1999 Provisional Regulations use the word

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219. *Id.*

220. *Id.*

221. *Id.*

222. *Id.*

223. EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 254.

224. *Id.*

225. *Id.*

226. *Id.*

227. *Id.*

228. The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 5 (6); The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art 41; The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 36.

229. Section Five (6) of the 1995 SPC Futures Judicial Guidelines states:

In futures trading, broker firm or client shall deposit additional margin as required by the regulations. If after having received a notice for depositing additional margin, the

“shall” (*yingdang*).<sup>230</sup> On the other hand, the 2003 SPC Futures Judicial Provisions use the words “have the right” (*youquan*).<sup>231</sup> Some argue that forced liquidation is an obligation of futures exchanges or futures broker firms because “shall” is used in the 1999 Provisional Regulations, thereby indicating that forced liquidation is an obligation rather than a right.<sup>232</sup> However, one can equally argue that forced liquidation is a right rather than an obligation because the words “have the right” are used in the 2003 SPC Futures Judicial Provisions.

In judicial practice, the most common forced liquidation occurs when futures broker firms close out a client’s positions.<sup>233</sup> In *Ningbo City Rongcheng Trading Co. v. Ningbo City Xinyuan Futures Brokerage Co.*, Rongcheng signed an entrustment agreement with Xinyuan for trading

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broker firm or client fail to deposit additional margin within the stipulated time limit, the exchange or broker firm may force liquidate the remaining futures contracts; losses resulting from a forced liquidation are borne by the broker firm or client. Where the exchange or broker firm does not fulfill its obligation to notify the broker firm or client, thereby causing losses as a result of the forced liquidation, the exchange or broker firm shall be liable to compensate the broker firm or client.

See The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 5 (6).

230. Article 41 of the 1999 Provisions Regulations states:

When a futures exchange member’s margin falls below the required level, the member must make an additional margin deposit. When the member fails to make the additional margin deposit within the time limit uniformly prescribed by the futures exchange, the futures exchange shall make a forced liquidation of the member’s futures contracts; the member bears the expenses and losses that result from the forced liquidation.

When a futures broker’s client’s margin falls below the required level, and the client fails to make an additional margin deposit within the time limit uniformly prescribed by the futures broker, the futures broker shall make a forced liquidation of the client’s futures contracts; the client bears the expenses and losses that result from the forced liquidation.

See The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 41.

231. Article 36 of the 2003 SPC Futures Judicial Provisions states:

When a futures broker’s margin falls below the required level, and the futures broker fails to make an additional margin deposit within the time limit prescribed by the futures exchange, it is to be dealt with in accordance with the trading rules; where the trading rules are not clear and definite, the futures exchange has the right to make a forced liquidation of the broker’s futures contracts, and the broker bears the expenses and losses that result from the forced liquidation.

When a client’s margin falls below the required level, and the client fails to make an additional margin deposit within the time limit prescribed by a futures brokerage agreement, it is to be dealt with in accordance with the provisions of the futures brokerage agreement; where the provisions are not clear and definite, the futures broker has the right to make a forced liquidation of the client’s futures contracts, and the client bears the expenses and losses that result from the forced liquidation.

See The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 36.

232. See ESSENTIAL EXPLANATIONS OF DIFFICULT ISSUES IN THE PRACTICE OF COMMERCIAL ADJUDICATION, *supra* note 210, at 278.

233. See *id.* at 285.

commodity futures at the Shanghai Commodity Exchange.<sup>234</sup> The clauses concerning closing out positions under certain circumstances were set out in the defendant's manual, the Measures for Risk Management, and several other firm documents.<sup>235</sup> Those clauses stipulated that the defendant would notify clients to increase their margins when the usage rate of the clients' funds reached a 130% shortfall.<sup>236</sup> The firm would notify a client before 11:00AM, and the client would be required to deposit the difference before 9:00AM the next day.<sup>237</sup> If the shortfall of the client's funds reached a certain point (300%), the firm would have the right to close out all the positions without notifying the client.<sup>238</sup>

By July 24, 1995, the plaintiff had purchased 2100 lots of 9509 glue board contracts from Xinyuan on the Shanghai Commodity Exchange.<sup>239</sup> On July 25, Rongcheng's funds usage rate reached 132% with a shortfall of 299,660 *yuan*.<sup>240</sup> Xinyuan prepared a notice that afternoon requiring Rongcheng to make up for the amount,<sup>241</sup> but the notice was not given to Rongcheng until 8:45am the next day.<sup>242</sup> On July 26, after receiving the notice, Rongcheng prepared the money and delivered it to Xinyuan at 9:25am; however, Xinyuan had already closed out all the positions at 9:22am, resulting in a loss of 2,145,800 *yuan*, including a commission charge of 37,800 *yuan*.<sup>243</sup> Rongcheng sued Xinyuan in the Intermediate People's Court of Ningbo City, claiming that Xinyuan's forced liquidation was invalid.<sup>244</sup> Xinyuan responded that the funds were below the required level and the forced sale was in accordance with the futures trading provisions.<sup>245</sup>

The Ningbo Intermediate People's Court found that the signed entrustment agreement, containing the clauses agreed by the parties regarding futures trading, was lawful and valid.<sup>246</sup> Although the defendant notified the plaintiff to deposit additional margin, it failed to issue the notice accordingly.<sup>247</sup> Under the circumstances, the forced sale by the defendant constituted a breach of contract; since there was a causal link

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234. *See id.* at 251–58.

235. *See id.* at 251–52.

236. *See id.* at 251.

237. *See id.* at 252.

238. *See* EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 251–52.

239. *Id.* at 252.

240. *Id.*

241. *Id.*

242. *Id.*

243. *Id.*

244. *See* EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 252.

245. *See id.*

246. *Id.* at 252–53.

247. *Id.* at 253.

between the forced sale and the losses suffered by the plaintiff, the defendant bore compensatory responsibilities.<sup>248</sup> Therefore, in accordance with Articles 4, 106 and 134(1)(vii) of the 1986 GPCL,<sup>249</sup> the Court mandated the defendant compensate the plaintiff for 2,145,000 *yuan*.<sup>250</sup>

*Ningbo Rongcheng* represents a common dispute where defendants fail to perform their notification obligation before taking a forced liquidation measure to close out their clients' positions. Plaintiffs usually argue that futures broker firms have a duty to liquidate under certain circumstances to protect their clients; if futures broker firms fail to take such a measure, they should be liable for plaintiff's losses.<sup>251</sup> Apart from the notification obligation, a forced liquidation must be "moderate"—that is, the size of the positions to be closed out should be limited to an appropriate amount.<sup>252</sup> In this respect, Article 41 of the 1999 Provisional Regulations failed to include a provision requiring a moderate forced liquidation,<sup>253</sup> but the 2003 SPC Futures Judicial Provisions address this issue.<sup>254</sup>

Before the 1995 SPC Futures Judicial Guidelines, the people's courts would consider the rules and practice of relevant international futures markets when adjudicating cases involving offshore futures transactions and the issue of forced liquidation. In *Zhao Xiaomei v. Nanjing Jinzhongfu International Futures Trading Co.*,<sup>255</sup> an earlier case involving trades of American coffee futures, the parties signed an agreement under which Zhao

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248. *Id.*

249. Article 4 of the 1986 GPCL states that "[c]ivil acts must abide by the principles of voluntariness, fairness, compensation for equal value, and good faith." 1986 GPCL, *supra* note 12, at Art. 4. Article 106 states that "(1) Citizens and legal persons who breach a contract or otherwise fail to fulfill obligations shall bear civil liability; (2) Citizens and legal persons who by fault infringe on state or collective property, or infringe on the person or property of others, shall bear civil liability." 1986 GPCL, *supra* note 12, at Art. 106. Article 134 (1) (vii) prescribes 'paying damages for the injuries' as one of the forms of bearing civil liability. 1986 GPCL, *supra* note 12, at Art. 134.

250. EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 253.

251. See, for example, PRINCIPLES AND PRECEDENTS OF FUTURES LITIGATION, *supra* note 191, at 446–47 (a case in which six plaintiffs argued that the forced liquidation measure was the defendant's duty; as the defendant failed to perform its duty to take a forced close out of the plaintiffs' positions on time, they should be liable for the losses caused to the plaintiffs) [PRINCIPLES AND PRECEDENTS OF FUTURES LITIGATION].

252. See ESSENTIAL EXPLANATIONS OF DIFFICULT ISSUES IN THE PRACTICE OF COMMERCIAL ADJUDICATION, *supra* note 210, at 286–87. See also EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 257.

253. See ESSENTIAL EXPLANATIONS OF DIFFICULT ISSUES IN THE PRACTICE OF COMMERCIAL ADJUDICATION, *supra* note 210, at 288.

254. Article 39 of the 2003 SPC Futures Judicial Provisions states that "A futures exchange or futures broker shall force the liquidation of only the number of positions substantially equal to the additional margin deposit that the futures broker or client needs. The loss caused by an excessive liquidation shall be borne by those who undertake the forced liquidation." The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 39.

255. See *Zhao Xiaomei v. Nanjing Jinzhongfu Int'l Futures Trading Co.*, in the Gazette of the Supreme People's Court, issue 3, 1994, at 117–19 (P.R.C.).

Xiaomei opened an account with Jinzhongfu and subsequently deposited US\$20,000.<sup>256</sup> Jinzhongfu closed out some of the positions in Zhao Xiaomei's account when the margin of Zhao Xiaomei's account fell below the 100% mandatory amount.<sup>257</sup> However, according to the rules for American coffee futures trading, Zhao Xiaomei's account should have been sustained overnight if the margin was above 50% of the mandatory margin, and at the time, the account's margin was below 100% but above 50% of the mandatory margin.<sup>258</sup>

The Nanjing Intermediate People's Court established that Jinzhongfu had closed out some of the positions in Zhao Xiaomei's account without first having agreed with Zhao Xiaomei.<sup>259</sup> The Court noted the parties' contractual relationship, whereby the defendant, in acting for its client in international futures trading, was required to comply with relevant international trading rules.<sup>260</sup> The Court held the defendant responsible for the forced liquidation taken in violation of the American coffee futures trading rules, and required that the defendant compensate the plaintiff US\$23,142, in accordance with Article 111 of the 1986 GPCL.<sup>261</sup> On appeal in the Jiangsu High People's Court, both the ruling and reasoning were upheld.<sup>262</sup>

The 2007 Regulations do not amend Article 41 of the 1999 Provisional Regulations beyond requiring that a member of a futures exchange or a client of a futures exchange make an additional margin or close out positions itself when the margin becomes insufficient.<sup>263</sup> The 2007

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256. *See Zhao Xiaomei*, at 117.

257. *See id.* at 118.

258. *See id.*

259. *See id.*

260. *See id.*

261. Article 111 of the 1986 GPCL states: "When one of the parties fails to fulfill its contractual obligations or performs its obligations in such a way as to violate the contractual provisions, the other party has the right to demand performance or remedial measures; the other party also has the right to demand compensation for losses." 1986 GPCL, *supra* note 12, at Art. 111.

262. *See Zhao Xiaomei*, at 119.

263. Article 38 of the 2007 Regulations on the Administration of Futures Trading states:

Where the amount of margin of a member of a futures exchange becomes insufficient, the member shall make an additional margin deposit in a timely manner or voluntarily close out the positions. Where the member fails to make the additional margin deposit or voluntarily close out the positions within the time limit prescribed by the futures exchange, the futures exchange shall make a forced liquidation of the member's futures contracts; the expenses connected with the forced liquidation and the losses incurred are to be borne by the member.

Where the amount of margin of a client of a futures broker becomes insufficient, the client shall make an additional margin deposit in a timely manner or voluntarily close out the positions. Where the client fails to make the additional margin deposit or voluntarily close out the positions within the time limit prescribed by the futures broker, the futures broker shall make a forced liquidation of the client's futures contracts; the expenses connected with the forced liquidation and the losses incurred are to be borne by the client.

Regulations stipulate, where a member of a futures exchange or a client of a futures company fails to make the required additional margin or close out positions itself within the time limit set out by the futures exchange or the futures company, the futures exchange or the futures company *must* make a forced liquidation of the futures contract of the member or the client, and the expenses connected with the forced liquidation and the losses incurred are to be borne by the member or the client.<sup>264</sup>

Commodities and financial futures exchanges have formulated their own trading rules to cover the circumstances, principles and procedures for forced liquidation, including notice requirements and the allocation of profits or losses connected with a forced liquidation.<sup>265</sup>

### VIII. THE RESPONSIBILITIES OF FUTURES EXCHANGES

Futures exchanges are responsible for the smooth day-to-day running of futures trading. One of the important responsibilities of a futures exchange is to guarantee performance of futures contracts in futures trading. Both administrative regulations and the judicial guidelines of the Supreme People's Court contain provisions illuminating this responsibility and defining the right and obligation of the futures exchange in guarantees made by the futures exchange. On a broad level, lessons have been learned from the early years of China's futures exchanges. Since that time, regulatory standards for operating futures exchanges aimed to ensure that appropriate supervision was in place and the operation of futures exchanges and futures trading was smooth and efficient.

The 1995 SPC Futures Judicial Guidelines provided that futures exchanges must guarantee performance of futures contracts in futures

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The language "close out positions themselves" was not provided for in Article 41 of the 1999 Provisional Regulations. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 38. See also The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 41.

264. See The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 38.

265. See Zhengzhou shang pin jiao yi suo qi huo jiao yi feng xian kong zhi guan li ban fa [Admin. Measures of the Zhengzhou Commodity Exch. on Risk Control of Futures Trading] ch. 6, *System of Forced Liquidation*, Arts. 46–53, (promulgated by Zhengzhou Commodity Exch. Governing Council, Mar. 28, 2009, effective Apr. 20, 2009), available at <http://www.czce.com.cn/file/czcerules20090415-3.htm> (P.R.C.); Da lian shang pin jiao yi suo feng xian guan li ban fa [Measures of the Dalian Commodity Exch. on Risk Mgmt] ch. 6, *System of Forced Liquidation*, Arts. 37–44 (promulgated by Dalian Commodity Exch. Governing Council, Oct. 29, 2007, effective Oct. 29, 2007), available at <http://www.dce.com.cn> (P.R.C.); Shanghai qi huo jiao yi suo feng xian kong zhi guan li ban fa [Admin. Measures of the Shanghai Futures Exch. on Risk Control] ch. 6, *System of Forced Liquidation*, Arts. 33–41 (promulgated by Shanghai Commodity Exch., Jan. 9, 2008, effective Jan. 9, 2008), available at [http://www.shfe.com.cn/docview/docview\\_50206012](http://www.shfe.com.cn/docview/docview_50206012) (P.R.C.); Zhongguo jin rong qi huo jiao yi suo feng xian kong zhi guan li ban fa [Admin. Measures of the China Financial Futures Exch. on Risk Control] ch. 6, *System of Forced Liquidation*, Arts. 25–33 (promulgated by China Fin. Futures Exch., June 27, 2007, effective June 27, 2007), available at [http://www.cffex.com/cn/wps/wcm/connect/cffex\\_de](http://www.cffex.com/cn/wps/wcm/connect/cffex_de) (P.R.C.).



trading.<sup>266</sup> If any party was unable to perform timely and wholly the obligation stipulated in a futures contract, the exchange was required to perform the obligation on the party's behalf or be liable for compensation.<sup>267</sup> The exchange then had the right to pursue repayment from the default party.<sup>268</sup> Moreover, the 1999 Provisional Regulations required any deposit of a member of the futures exchange to be used first to satisfy the liabilities in any breach of contract; if the deposit was insufficient, the futures exchange, as required by the regulations, would use the risk reserve fund and its own funds to satisfy the liabilities on behalf of its member, and thus acquire the right to pursue repayment from the member after settlement.<sup>269</sup>

The 1995 SPC Futures Judicial Guidelines and the 1999 Provisional Regulations failed to elaborate on the nature of the guarantee undertaken by the futures exchange. One interpretation, called the civil law "guarantee" (*baozheng*), considered trading conducted by members of the exchange to be guaranteed by the exchange's own funds.<sup>270</sup> Yet the difference between the guarantee undertaken by the futures exchange and an ordinary civil law guarantee was that the futures exchange could use its regulatory means to first take funds from the defaulting party or the risk reserve funds to satisfy the liabilities for the breach of contract, even though no such right exists in an ordinary civil law guarantee.<sup>271</sup> Therefore, the interpretation of such a guarantee as a "mixed type guarantee" (*hunhexing danbao*) was more appropriate in that it combined the features of a civil law guarantee and a right of self-regulation.<sup>272</sup>

The 2003 SPC Futures Judicial Provisions provides further procedural rules consistent with the 1995 SPC Futures Judicial Guidelines and the 1999 Provisional Regulations. If a futures exchange does not perform futures contracts on behalf of a futures broker firm, the futures broker firm must make claims on the futures exchange according to its clients' requests.<sup>273</sup> If the futures broker firm refuses to do so, the clients may sue the futures exchange directly, and the futures broker firm may join the

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266. See The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 5 (1).

267. See The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 5 (1).

268. See The 1995 SPC Futures Judicial Guidelines, *supra* note 7, at Sec. 5 (1).

269. Article 44 (1) of the 1999 Provisional Regulations on the Administration of Futures Trading states that "Where any member breaches the contract in futures trading, the futures exchange shall first use the member's margin to bear the liability for breach of contract. If the margin is insufficient, the futures exchange shall use the risk reserve fund and its own funds to bear the liabilities on behalf of the member, and thus acquire the right to pursue repayment from the member in question." See The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 44 (1).

270. See ESSENTIAL EXPLANATIONS OF DIFFICULT ISSUES IN THE PRACTICE OF COMMERCIAL ADJUDICATION, *supra* note 210, at 298.

271. *Id.*

272. See *id.*

273. The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 49 (1).

proceedings as a third party.<sup>274</sup> The 2003 SPC Futures Judicial Provisions clearly define the right and obligation of the futures exchange in guarantees made by the futures exchange. If a futures broker firm fails to perform pecuniary obligations according to the requirements of a daily mark-to-market settlement system and the futures exchange does not perform the obligation on behalf of the futures broker firm, the futures exchange is liable for the loss caused to the other trading party, and may recover from the defaulting party.<sup>275</sup>

One case, *Hainan Zhongqing Jiye Development Centre v. Sichuan Pingyuan Industrial Development Co.*,<sup>276</sup> which involved trading of natural rubber futures R708 contracts in 1997, illustrates a futures exchange's right to pursue repayment from a defaulting party after the futures exchange performed an obligation on behalf of a futures broker firm. On April 5, 1997, the defendant Sichuan Pingyuan privately signed a "seat transfer agreement" with Sichuan Hezheng, a third party futures broker firm.<sup>277</sup> Both Pingyuan and Hezheng were members of the Zhongshang Futures Exchange.<sup>278</sup> Under the agreement, Pingyuan transferred its seat (No. 165) to Hezheng for a fee of 300,000 yuan.<sup>279</sup> The transfer agreement was not reported to the Zhongshang Futures Exchange and therefore violated a trading rule prohibiting such transfers. The Supreme People's Court found the true nature and purpose of the agreement was to rent the seat privately.<sup>280</sup> Therefore, the Court rejected Pingyuan's argument against liability for any consequences of trading connected with its seat.

On July 29, 1997, seat 165 held 4250 lots of R708 contracts.<sup>281</sup> The Zhongshang Futures Exchange issued a notice informing seat 165 that its deposit was insufficient and must be reconciled before the opening of the next trading day.<sup>282</sup> Subsequently, seat 165 closed out 917 lots and 3333 lots remained.<sup>283</sup> Shortly thereafter, the Zhongshang Futures Exchange notified seat 165 that no sufficient deposit had been made for the 3333 lots, and claimed a breach of contract.<sup>284</sup> According to the settlement rules of the

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274. The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 49 (2).

275. The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 49 (1)–(2).

276. See *Hainan Zhongqing Jiye Dev. Ctr. v Sichuan Pingyuan Indus. Dev. Co.*, in *Gazette of the Supreme People's Court*, issue 4, 2005, at 25–30 (P.R.C.). Hainan Zhongqing Jiye Development Centre used to be Hainan Zhongshang Futures Exchange located in Haikou city, Hainan province, whose name was changed in 2000 during the proceedings.

277. *Hainan Zhongqing Jiye Dev. Ctr.*, at 25.

278. *Id.*

279. *Id.*

280. The CSRC investigated into the irregularities and market manipulation connected with the trading of R708 rubber futures contracts in the Zhongshang Futures Exchange in 1997 and concluded that the Pingyuan Company had rented out its seat and violated the regulation. See *id.* at 25–30.

281. *Id.* at 26.

282. *Id.*

283. *Hainan Zhongqing Jiye Dev. Ctr.*, at 26.

284. *Id.*

Zhongshang Futures Exchange, 20% of total price of the commodity, or 37,196,280 *yuan*, was due in penalty fees.<sup>285</sup> An amount of 7,692,280 *yuan* was taken from Pingyuan's account, and because Pingyuan failed to pay the balance, the Zhongshang Futures Exchange paid the remaining 29,503,999.14 *yuan*.<sup>286</sup> The Zhongshang Futures Exchange later sued Pingyuan in Sichuan High People's Court, claiming it was due a refund of the 29,503,999.14 *yuan* from Pingyuan.<sup>287</sup> Because the Zhongshang Futures Exchange guaranteed performance of futures contracts, its obligation to reconcile any shortfall after a defaulting party failed to perform timely and wholly the obligation stipulated in a futures contract consequently gave rise to a right to reimbursement.

The Sichuan High People's Court held that in the course of futures trading, a futures exchange should guarantee performance of futures contracts; if any party is unable to perform timely and wholly the obligation stipulated in the futures contracts, the futures exchange shall perform on the party's behalf and thus acquire the right to a refund.<sup>288</sup> The Court affirmed the Zhongshang Futures Exchange's payment of 29,503,999.14 *yuan* for seat 165 for breach of contract because sufficient evidence indicated that such recovery complied with the regulation.<sup>289</sup> On the other hand, the Court said the Zhongshang Futures Exchange had contributed to the breach and should bear the responsibilities jointly with Pingyuan.<sup>290</sup> The Court found that Zhongshang Futures Exchange issued sufficient notice, reminding the members controlling the amount of positions of rubber futures contracts. It was of no import that the Zhongshang Futures Exchange had issued a notice to all members on July 25, requiring each member to hold no more than 200 lots of positions of rubber futures contracts in the settlement month; the Zhongshang Futures Exchange allowed seat 165 to open new positions of 1000 lots on July 28, and 3150 lots on July 29 when seat 165's funds were insufficient on July 29.<sup>291</sup> The Court said this transaction violated the CSRC stipulations on strict control of the overall amount of positions<sup>292</sup> and also

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285. *Id.*

286. *Id.*

287. *Id.* at 27.

288. *Id.*

289. *Hainan Zhongqing Jiye Dev. Ctr.*, at 27.

290. *See id.*

291. *See id.*

292. *See id.* at 27. In 1995, the CSRC issued the Circular on Further Controlling Risks of Futures Markets and Sternly Striking Market Manipulation (*Guan yu cao zong jin yi bu kong zhi qi huo shi chang feng xian, yan li da ji shi chang xing wei de tong zhi*), which stipulated that all futures exchanges must strictly control the total amount of outstanding positions in the market. T+0 settlement, which was the practice of same-day settlement of trades, was prohibited. *See* Guan yu cao zong jin yi bu kong zhi qi huo shi chang feng xian yan li da ji shi chang xing wei de tong zhi [Notice on Further Controlling Risks of Futures Markets & Sternly Striking Market Manipulation] Points 1 & 2 (promulgated by the China Sec. Regulatory Comm'n, Oct. 24, 1995), available at <http://shanghai.csrc.gov.cn/n575458/n575727/n575802/1994719.htm> (P.R.C.).

violated the prohibition of “T+0 settlement”—that is, a prohibition on the futures exchanges’ strategy of opening new positions by closing out positions on the same day to yield profit margins.<sup>293</sup> In accordance with Articles 84, 106(1) and 130 of the 1986 GPCL,<sup>294</sup> the Court ruled that the Zhongshang Futures Exchange and Pingyuan must each pay 18,598,140 *yuan* for the breach.<sup>295</sup> The Zhongshang Futures Exchange appealed to the Supreme People’s Court, which overturned the judgment of the Sichuan High People’s Court, citing Article 44 (1) of 1999 Provisional Regulations,<sup>296</sup> Section Five (1) of the 1995 SPC Futures Judicial Guidelines,<sup>297</sup> and Articles 153(1)(ii) and (iii) and 158 of the 1991 Civil Procedure Law.<sup>298</sup>

The Supreme People’s Court’s reasoning in the appeal was threefold. First, “as long as it [could be established] that the Zhongshang Futures Exchange paid the fees on behalf of Pingyuan for the breach of contract, Pingyuan should, pursuant to the law, repay the Zhongshang Futures Exchange.”<sup>299</sup> The division of responsibilities among the parties involved in seat 165’s trading was a different legal relationship from the issue of claiming repayment by the Zhongshang Futures Exchange; the only issue the lower court should have tried in the proceedings was the claim for repayment, not the responsibilities resulting from seat 165’s trading.<sup>300</sup>

293. See *Hainan Zhongqing Jiye Dev. Ctr.*, at 27.

294. Article 84 of the 1986 GPCL states: “A debt is a special right and obligation created between parties according to contractual agreements or legal provisions. The party who has the right to enforce the obligation is the creditor. The party who bears the obligation is the debtor.” 1986 GPCL, *supra* note 12, at Art. 84. Article 106 (1) states, “[c]itizens and legal persons who breach a contract or otherwise fail to fulfill obligations shall bear civil liability.” 1986 GPCL, *supra* note 12, at Art. 106 (1). Under Article 130, “[w]hen two parties or more jointly infringe another party’s right and cause damages, the infringing parties are jointly and severally liable.” The creditor has the right to demand the debtor to fulfill their obligations according to the contractual agreements or legal provisions. See 1986 GPCL, *supra* note 12, at Art. 130.

295. *Hainan Zhongqing Jiye Dev. Ctr.*, at 28.

296. See The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32.

297. The 1995 SPC Futures Judicial Guidelines, *supra* note 7.

298. *Hainan Zhongqing Jiye Dev. Ctr.*, at 29–30. According to Article 153 (1) of the 1991 Civil Procedure Law:

The People’s Court of Second Instance, after having heard the case on appeal, shall proceed as the following conditions prescribe:

(ii) If the original judgment was mistaken in its application of law, the Court of Second Instance shall amend the original judgment according to the law.

(iii) If the original judgment was mistaken in its fact findings, or if the original judgment was ambiguous in its fact findings, or if the original judgment was based on insufficient evidence, the Court of Second Instance shall set aside the original judgment and remand the case to the People’s Court for retrial, or the Court of Second Instance may amend the judgment after an investigation of the facts.

See 1991 Civil Procedure Law, *supra* note 11, at Art. 153 (1).

299. *Hainan Zhongqing Jiye Dev. Ctr.*, at 28.

300. *Id.* at 28–29.

Second, there was no inevitable and causal link between the Zhongshang Futures Exchange's violation of relevant regulations and rules and Pingyuan's breach of contract.<sup>301</sup> Third, the Zhongshang Futures Exchange's liability for violating the CSRC stipulation and T+0 settlement restriction was merely related to an administrative responsibility.<sup>302</sup> Therefore, the judgment of the Sichuan High People's Court confused the allocation of liability: the Zhongshang Futures Exchange was liable for the administrative responsibility, not for a breach of contract.<sup>303</sup> The Supreme People's Court ruled that Pingyuan must repay the plaintiff an amount of 29,503,999.14 *yuan* and any applicable interests; moreover, all the court costs would be borne by Pingyuan.<sup>304</sup>

Needless to say, futures exchanges play an important role in futures trading. Smooth and efficient futures trading depends upon a well-regulated futures market and the role played by the futures exchange. For example, in *Ding Wei v. Zhengzhou Commodity Exchange*,<sup>305</sup> the Zhengzhou Commodity Exchange was blamed for a lack of appropriate supervision and control, creating conditions for serious violations of the rules by some members of the exchange.<sup>306</sup> *Ding Wei v. Zhengzhou* was not an isolated case, particularly in the early years of China's futures market.

The 1999 Provisional Regulations listed a series of regulatory standards for operating futures exchanges, such as establishing a risk reserve fund and other risk management systems,<sup>307</sup> and establishing comprehensive rules

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301. *Id.* at 29.

302. *Id.* at 29.

303. See UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 333.

304. *Hainan Zhongqing Jiye Dev. Ctr.*, at 30.

305. See UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 249–61.

306. UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 260. The Supreme People's Court, the appellate court in this case, found that the Zhengzhou Commodity Exchange allowed T+0 settlement until December 1996 and including when the dispute occurred, which was a violation of the ban on T+0 settlement, as stated in the CSRC's 1995 Circular on Further Control Risks of Futures Market and Sternly Strike Market Manipulation. One commentator noted that the inappropriate and ineffective supervision and control by the Zhengzhou Commodity Exchange, coupled with the violation of regulations by the Zhengzhou Commodity Exchange itself, were indispensable conditions for serious violations of the rules by a few big players of the exchange. *Id.* at 255, 260.

307. See The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 35. Futures exchanges should establish and improve the following risk management systems hereunder, pursuant to relevant [PRC] statutory provisions:

1. the security deposit system;
2. the daily settlement system;
3. the Maximum Daily Price Fluctuation Limits System;
4. the position limits and large open position reporting system;
5. the risk reserve fund system;

and codes of conduct for engaging in trading activities, managing risk control and supervising work staff of futures exchanges.<sup>308</sup> The 2003 SPC Futures Judicial Provisions, on the other hand, clearly defined compensatory liabilities of futures exchanges in different aspects of futures trading. It covered the liabilities related to the notification duty of futures exchanges,<sup>309</sup> the futures exchange's responsibilities in trading with overdraft,<sup>310</sup> the actions concerning forced liquidation,<sup>311</sup> and the liabilities from settlement of physical commodities.<sup>312</sup>

The regulatory standards set out in the 1999 Provisional Regulations continue to take effect under the 2007 Regulations.<sup>313</sup> If a futures exchange grants a guarantee and there is a breach of contract, the 2007 Regulations are akin to the 1999 Provisional Regulations in requiring the member's deposit to be used first to satisfy the liabilities. If the breaching member's deposit is insufficient, the futures exchange then uses the risk reserve fund and its own fund to satisfy the liabilities on behalf of the member, and thus acquires the right to pursue repayment from the member.<sup>314</sup> This mechanism, together with the provisions in the 2003 SPC Futures Judicial Provisions,<sup>315</sup> ensures smooth transactions in futures exchange.

## IX. THE FINANCIAL FUTURES MARKET AND FINANCIAL FUTURES TRADING

China's financial futures market developed in parallel with the commodity futures market. In June 1993, the State Administration of Foreign Exchange issued the Trial Measures for the Administration of Foreign Exchange Futures Business,<sup>316</sup> which set out basic regulatory rules concerning foreign exchange futures (*waihui qihuo*) and foreign exchange deposit (*waihui anjin*) trading. Two types of business institutions were

6. And other risk management systems prescribed by the CSRC.

The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 35.

308. *See* The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 55.

309. The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 25 (1).

310. The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Arts. 31 (1), 32 (1), 33 (1), 34 (1), and 35 (1).

311. The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Arts. 39, 40.

312. The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Arts. 45, 47.

313. *See* The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at ch. 2, Arts. 6–14 (a majority of which are the same provisions as stipulated in Chapter 2 of the 1999 Provisional Regulations on the Administration of Futures Trading, including Arts. 6–20). *See also* The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Arts. 6–20.

314. *See* The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 40 (1).

315. The 2003 SPC Futures Judicial Guidelines, *supra* note 7, at Art. 48.

316. *Wai hui qi huo ye wu guan li shi xing ban fa* [Trial Measures for the Admin. of Foreign Exch. Futures Bus.] (promulgated by the St. Admin. of Foreign Exch., June 9, 1993 upon an approval by the People's Bank of China, effective June 9, 1993, repealed Mar. 27, 1996), available at ISINOLAW (last visited May 18, 2009) (P.R.C.) [hereinafter *The Trial Measures for the Admin. of Foreign Exch. Futures Bus.*].

allowed to engage in foreign exchange futures and deposit trading: financial institutions that had licences to engage in spot foreign exchange dealings as an agent for clients, and joint ventures set up by such financial institutions as a special foreign exchange futures broker firm.<sup>317</sup> In both cases, the entity was required to meet certain conditions to be approved by the State Administration of Foreign Exchange.<sup>318</sup> Six currencies were included as applicable currencies.<sup>319</sup> Trades were made by a foreign futures broker under a signed agreement with the Chinese financial institution or joint venture.<sup>320</sup> The foreign futures broker would provide market information and other services.<sup>321</sup>

As in the commodity futures market, illegal activities and excessive speculation became a serious problem in the foreign exchange futures market. Many illegal trading institutions emerged, engaging in foreign exchange futures and deposit trading without authorization from government regulators. Enterprise clients and individual clients suffered increasingly serious losses, affecting the stability of financial order.<sup>322</sup> This prompted the government to embark on a campaign to crack down on illegal activities in the foreign exchange futures market. Between October 1994 and June 1997, a series of government notices were issued, including the Notice on Sternly Investigating and Dealing with Illegal Trading Activities in Foreign Exchange Futures and Foreign Exchange Deposit

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317. See The Trial Measures for the Admin. of Foreign Exch. Futures Bus., *supra* note 317, at Art. 3.

318. The Trial Measures for the Admin. of Foreign Exch. Futures Bus., *supra* note 317, at Arts. 9 & 10. One of the conditions, for example, was that the applicant should have no less than \$7 million paid-up capital or an equivalent amount of other foreign currencies. See The Trial Measures for the Admin. of Foreign Exch. Futures Bus., *supra* note 317, at Art. 10 (2).

319. They were sterling pound, deutsche mark, Japanese yen, Swiss franc, US dollar, and HK dollar. See The Trial Measures for the Admin. of Foreign Exch. Futures Bus., *supra* note 317, at Art. 6.

320. The Trial Measures for the Admin. of Foreign Exch. Futures Bus., *supra* note 317, at Art. 15.

321. The Trial Measures for the Admin. of Foreign Exch. Futures Bus., *supra* note 317, at Art. 16.

322. See Guo jia wai hui guan li ju guan yu jia qiang wai hui (qihuo) jiao yi guan li de tong zhi [Notice of the St. Admin. of Foreign Exch. on Strengthening Foreign Exch. (Futures) Trading] (promulgated by the St. Admin. of Foreign Exch., Apr. 21, 1993), available at <http://china.findlaw.cn/fagui/ms/23/35600.html> (last visited May 18, 2009) (P.R.C.). In the introduction, the Circular pointed out that:

[T]hese illegal trading firms operate under confusing fee structures and chaotic management, some even defraud their clients, causing increasingly damaging losses to clients, which comprise of institutions and individuals. A number of clients who were defrauded and suffered serious losses wrote letters to relevant governmental agencies to complain, and requested compensation for the losses. This situation has affected the stability of the domestic financial markets.

*Id.*

Trading.<sup>323</sup> These government notices suspended the trading of foreign exchange futures and deposit trading for an indefinite time.<sup>324</sup>

The main disputes arising from the trading of foreign exchange futures or deposits involved enterprise clients or individual clients and financial institutions or joint ventures acting as the agents. Clients lost money in futures trading when agents conducting the trading violated foreign exchange regulations. In *He Wei v. Changchun Investment Consultancy Centre of Jilin Province Jinhui International Investment and Development Co. Ltd and Jilin Branch of Bank of China*, the plaintiff lost 84,500 yuan while trading foreign exchange deposits.<sup>325</sup> The defendants did not have authorization to engage in foreign exchange futures business.<sup>326</sup> In *Yang Limin v. Xinjiang Olympic Development General Company*, another plaintiff lost 316,000 yuan while trading foreign exchange deposits,<sup>327</sup> again, the defendant was not approved to engage in foreign exchange futures business as an agent acting on behalf of clients.<sup>328</sup> In both cases, the people's courts annulled the parties' signed agreements on the grounds that the defendants lacked authorization to engage in foreign exchange futures business and to act on behalf of clients.<sup>329</sup>

The fundamental issue in these cases was whether the clients should be compensated with their losses by the defendants under these circumstances. The courts referred to the 1995 SPC Futures Judicial Guidelines and distinguished between losses which had a direct causal link to the clients' instructions and losses which were linked to the defendants' actions. Plaintiffs could not recover from the defendants in the former instance, but could recover in the latter instance. In *He Wei*,<sup>330</sup> losses suffered by the plaintiff were a result of the plaintiff's order as executed by the defendants; therefore, the plaintiff should bear those losses. However, the Court also

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323. The Notice on Sternly Investigating & Dealing with Illegal Trading Activities in Foreign Exch. Futures & Foreign Exch. Deposit Trading, *supra* note 29.

324. See The Notice on the Summary of the Meeting Implementing the Notice on Sternly Investigating & Dealing with Illegal Trading Activities in Foreign Exch. Futures & Foreign Exch. Deposit Trading, *supra* note 29.

325. See *Dian xing an li ping shu ji fa lu lou dong bu chong* [COMMENTARY ON TYPICAL CASES AND COMPLEMENT TO LEGAL DEFICIENCY] 446 (Cai Zhang et al. eds., The People's Court Publishing House, 2002) (discussing *He Wei v. Changchun Inv. Consultancy Ctr. of Jilin Province*) [hereinafter COMMENTARY ON TYPICAL CASES AND COMPLEMENT TO LEGAL DEFICIENCY].

326. See COMMENTARY ON TYPICAL CASES AND COMPLEMENT TO LEGAL DEFICIENCY, *supra* note 326, at 453 (discussing *He Wei v. Changchun Inv. Consultancy Ctr. of Jilin Province*).

327. See *Zhong guo shen pan an li yao lan* [ESSENTIAL SELECTION OF ADJUDICATED CASES IN CHINA: CIVIL ADJUDICATED CASES] 433 (Nat'l Judges College and Sch. of Law of the People's Univ. of China eds., China People's Univ. Press Vol. 2001, 2002) [hereinafter ESSENTIAL SELECTION OF ADJUDICATED CASES IN CHINA: CIVIL ADJUDICATED CASES].

328. See ESSENTIAL SELECTION OF ADJUDICATED CASES IN CHINA: CIVIL ADJUDICATED CASES, *supra* note 328, at 435.

329. ESSENTIAL SELECTION OF ADJUDICATED CASES IN CHINA: CIVIL ADJUDICATED CASES, *supra* note 328, at 434.

330. See COMMENTARY ON TYPICAL CASES AND COMPLEMENT TO LEGAL DEFICIENCY, *supra* note 326, at 445–55 (discussing *He Wei v. Changchun Inv. Consultancy Ctr. of Jilin Province*).



established that the defendants provided the plaintiff with incorrect trading receipts as a result of carelessness by its staff member, which misled the plaintiff, and therefore defendant bore some responsibility.<sup>331</sup> Furthermore, there were other factors in the course of defendant's transaction with the plaintiff that contributed to the losses.<sup>332</sup> Based on these findings, the Court ruled that the defendants should bear certain limited liabilities for the losses.<sup>333</sup>

In *Yang Limin*, the defendant proved that it had executed the orders according to the plaintiff's instructions, and therefore the plaintiff's loss was directly caused by her instructions.<sup>334</sup> Even though the defendant was operating a foreign exchange futures business illegally, the lack of causation to the plaintiff's loss shielded him from liability. The Wulu Muqi Intermediate People's Court, in following the 1995 SPC Futures Judicial Guidelines, rejected the plaintiff's claim for compensation, reasoning that the loss suffered by the plaintiff was due to a normal trading risk.<sup>335</sup>

*He Wei* spurred different views regarding the legal consequences of an invalid agreement between the plaintiff and defendant. According to the first view, the plaintiff's loss of deposits should be returned to him.<sup>336</sup> If the defendant had no authorization to act for its clients in the foreign exchange futures business, then the brokerage agreement was invalid and the plaintiff should be restored to his status before entering into the agreement.<sup>337</sup> The second view argues that the defendant is responsible for the invalid agreement and the plaintiff has no fault in the process. Therefore, the loss should be borne by the defendant.<sup>338</sup> The third view argues that the loss should be borne according to the fault of each party; if both are at fault, the agreement should be determined null and void.<sup>339</sup> The fourth view notes that the defendant lacks authorization to act for the plaintiff in foreign exchange futures trading, but asserts that if the defendant executed the order in accordance with the plaintiff's instructions, then the plaintiff should bear the loss caused by any market risks.<sup>340</sup> Therefore, illegal trading by the

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331. *Id.* at 453.

332. The plaintiff's designated broker from the defendant Jinhui International Investment & Development Co., continued to notify the plaintiff demanding additional deposits even after the defendant Jinhui, knowing that its involvement in trading of futures exchange deposit was illegal, cancelled the contract with the plaintiff. *Id.*

333. *Id.* at 453.

334. See ESSENTIAL SELECTION OF ADJUDICATED CASES IN CHINA: CIVIL ADJUDICATED CASES *supra* note 328, at 434 (discussing *Yang Limin v. Xinjiang Olympic Dev. General Company*).

335. *Id.*

336. See COMMENTARY ON TYPICAL CASES AND COMPLEMENT TO LEGAL DEFICIENCY, *supra* note 326, at 454 (discussing *He Wei v. Changchun Inv. Consultancy Ctr. of Jilin Province*).

337. *Id.*

338. *Id.*

339. *Id.*

340. *Id.* at 455.

defendant without authorization would be an indirect cause and the defendant should not be held liable for the loss.<sup>341</sup> This last view was the one adopted by the people's courts and is consistent with the 1995 SPC Futures Judicial Guidelines.

As part of government efforts to limit illegal activities and excessive speculation in the futures market, offshore trading of futures contracts, including financial futures products, was halted in late 1994.<sup>342</sup> When clients lost money in offshore financial futures products trading, disputes in the people's courts increased, particularly concerning the relevance of the lack of authorization to trade.<sup>343</sup> In *Qingyuan City Overseas Chinese Commodity Company v. Qingyuan City Tongye International Futures Trading Firm*, the plaintiff lost approximately two million yuan while trading defendant's various commodity and financial futures products on the Chicago Mercantile Exchange, including Standard and Poor's 500 Index futures.<sup>344</sup> The defendant was neither approved nor registered to engage in the trading of offshore futures products.<sup>345</sup> The Court annulled the agreement signed between the parties and ordered the defendant to return the plaintiff's deposit.<sup>346</sup> However, the Court rejected the plaintiff's claim for further losses apart from the deposit, reasoning that further losses should be borne by the plaintiff because the plaintiff could have mitigated the losses.<sup>347</sup> With regard to plaintiff's additional claims of an invalid contract for trading of offshore financial futures products, the court ruled that the liabilities must be divided between the parties in accordance with general principles of law, regulation and the judicial guidelines applied in other types of futures disputes.<sup>348</sup>

Trading of government bond futures was also a part of the financial futures market in the early 1990s.<sup>349</sup> In February 1995, the CSRC and the

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341. *Id.*

342. See The Notice on Relevant Issues about Cancellation by Futures Broker Firms of Offshore Futures Bus., *supra* note 31.

343. See The Notice on Sternly Investigating and Dealing with Illegal Trading Activities in Foreign Exch. Futures and Foreign Exch. Deposit Trading, *supra* note 29 ("These illegal trading activities, . . . resulted in a large number of economic disputes, . . . a continuous increase of complaints.").

344. See EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 241 (discussing *Qingyuan City Overseas Chinese Commodity Co. v. Qingyuan City Tongye Int'l Futures Trading Firm*).

345. See EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 243.

346. *Id.* at 242.

347. *Id.* at 243.

348. *Id.*

349. On December 2, 1992, the Shanghai Stock Exchange introduced twelve government bond futures products, beginning a trial run of government bond futures trading. For a brief history of the government bond futures market in early 1990s, see Li Yimei, *Wo guo guo zhai qi huo li shi hui gu* [*A Historical Review of Our Country's Government Bond Futures*], *He zuo jing ji yu keji* [CO-OPERATIVE ECONOMY & SCIENCE], Issue 341 at 66-68 (Mar. 2008) [hereinafter CO-OPERATIVE ECONOMY & SCIENCE].

Ministry of Finance jointly issued the Provisional Measures on the Administration of Government Bond Futures Trading,<sup>350</sup> which set forth qualifications of government bond futures exchanges and regulations for member firms, trading rules, and management of member firms. Yet at the same time government bond futures trading was dominated by market manipulation. In February 1995, Shanghai Wanguo International Securities, the second largest securities firm in China at that time, “wilfully violated trading rules by rigging prices” and selling government bond futures on a large scale to cover positions in excess of permitted limits.<sup>351</sup>

Shortly after this incident, the CSRC issued an urgent notice immediately preventing all futures exchanges from allowing members to open any new positions and also requiring existing positions to be closed out by the end of May 31, 1995.<sup>352</sup> The CSRC gave three reasons for closing the government bond futures market.<sup>353</sup> First, several serious regulatory violations had occurred in government bond futures trading in the prior few months, bringing about serious adverse effects inside and outside of China.<sup>354</sup> Second, China’s basic economic conditions were not ready for the development of a government bond futures trading market.<sup>355</sup> Third, the closure was necessary to maintain economic and social stability, and to protect healthy development of the financial market.<sup>356</sup> The brevity

350. Guo zhai qi huo jiao yi guan li zan xing ban fa [Provisional Measures on the Admin. of Gov’t Bond Futures Trading] (promulgated by the China Sec. Regulatory Comm’n & the Ministry of Fin., Feb. 23, 1995), *available at* ISINOLAW (last visited May 18, 2009) (P.R.C.).

351. For more details, see SECURITIES REGULATION IN CHINA, *supra* note 68, at 121.

352. The Urgent Notice on Suspension of Trials of Gov’t Bond Futures Trading, *supra* note 30.

353. The Urgent Notice on Suspension of Trials of Gov’t Bond Futures Trading, *supra* note 30.

354. The Urgent Notice on Suspension of Trials of Gov’t Bond Futures Trading, *supra* note 30.

355. The Urgent Notice on Suspension of Trials of Gov’t Bond Futures Trading, *supra* note 30.

356. The Urgent Notice on Suspension of Trials of Gov’t Bond Futures Trading, *supra* note 30.

The Circular ordered the closure of the government bond futures market. The decision was prompted by several serious regulatory violations that had occurred in the government bond futures market, which caused significant concern on the part of the government regarding the adverse effects the violations had on the stability of the country’s financial order, the broad economic and social stability, and the international image of China. Examining the bigger picture at that time, the government’s decision to close down the government bond futures market was understandable; in 1995, China lacked the necessary conditions for a proper financial futures market. The Circular of the State Council on Further Strengthening Macro-administration of Securities Market (*Guowuyuan guan yu jin yi bu jia qiang zheng quan shi chang hong guan guan li de tong zhi*), issued on December 17, 1992, stated that “the legal, regulatory and supervisory systems for China’s securities market were not fully established; there was a lack of experiences of operating the securities market; and investors had no necessary awareness of the market risks.” The Notice of the St. Council on Further Strengthening Macro-administration of the Sec. Mkt., *supra* note 52. In the Circular of the State Council on Firmly Stopping Blind Development of the Futures Market (*Guowuyuan guan yu jian jue zhi zhi qi huo shi chang mang mu fa zhan de tong zhi*), issued by the State Council on November 14, 1993, the government emphasized that “a futures market, as an advanced form of market development, has high potential for risk and speculation, therefore requiring a significant level of regulation. In light of the country’s current circumstances, apart from selecting a few kinds of commodities and locations for market trials, the futures market must be strictly controlled and cannot be developed blindly.” The Notice of the St. Council on Firmly Stopping Blind Dev. of the Futures Mkt., *supra* note 4.

of this CSRC notice strongly suggests the urgency for the closure of the government bond futures market at that time.

The closure was prompted by a series of serious regulatory violations that occurred in the government bond futures market between February and May 1995.<sup>357</sup> The government was concerned about the adverse effects those violations had on the country's economic, financial and social stability, and the effect on the outside world's perception of China as a commercially open and economically reformed country.<sup>358</sup> Besides these concerns, there were other reasons contributing to the government's decision to close down the government bond futures market. In the 1992 Notice of the State Council on Further Strengthening Macro-administration of Securities Market<sup>359</sup> the government noted that a legal, regulatory and supervisory system for China's securities market was not fully established;<sup>360</sup> there was insufficient experience to operate the securities market<sup>361</sup> and investors did not have full awareness of the risks involved.<sup>362</sup> In 1993, the government again emphasized that the futures market must be strictly controlled and cannot be developed blindly.<sup>363</sup>

In 2005, ten years after its closure, government bond futures trading and financial bond futures trading resumed on the inter-bank bond market.<sup>364</sup> In 2006, the establishment of the CFFEX marked a new stage in the process of formalization and standardization of China's financial futures market and financial futures trading.<sup>365</sup> However, financial futures trading was shut down or suspended soon afterwards by swift government actions, primarily

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357. For a review of the events that happened between February and May 1995 in the government bond futures market, see CO-OPERATIVE ECONOMY & SCIENCE, *supra* note 350, at 66–68 (Mar. 2008); Qiao Liang, “2.23” Guo zhai qi huo shi jian hui gu [*A Review of the “2.23” Event in Government Bond Futures*], *Zhong guo tou zi yu jian she* [CHINA INVESTMENT AND CONSTRUCTION], Issue 2 at 45–47 (1997).

358. The Urgent Notice on Suspension of Trials of Gov't Bond Futures Trading, *supra* note 30.

359. The Notice of the St. Council on Further Strengthening Macro-administration of the Sec. Mkt, *supra* note 52.

360. The Notice of the St. Council on Further Strengthening Macro-administration of the Sec. Mkt., *supra* note 52.

361. The Notice of the St. Council on Further Strengthening Macro-administration of the Sec. Mkt., *supra* note 52.

362. The Notice of the St. Council on Further Strengthening Macro-administration of the Sec. Mkt., *supra* note 52.

363. See The Notice of the St. Council on Firmly Stopping Blind Dev. of the Futures Mkt., *supra* note 4.

364. Regulations for the inter-bank bond market were enacted in 2005. See The Provisions on the Admin. of Bond Futures Trading on Nat'l Inter-bank Bond Mkt., *supra* note 54.

365. The establishment of the CFFEX and its significance was widely reported and commented on in Chinese media. See, for example, Shi Jianhua, Gu zhi qi huo jiang kai chuang zhong guo jin rong xin shi dai [*Share Index Futures Will Open up a New Era of China's Finance*] in *Zheng quan ri bao* [SECURITIES DAILY], Dec. 21, 2007, available at [http://cnstock.xinhuanet.com/stockindex/2007-12/21/content\\_2875419.htm](http://cnstock.xinhuanet.com/stockindex/2007-12/21/content_2875419.htm) (commenting on the significance of the establishment of the CFFEX and the launch of CSI 300 index futures contract).

due to widespread illegal trading and excessive speculation.<sup>366</sup> The gradual re-opening of the trading markets in the 2000s suggests that the tough government actions and regulations taken in 1990s, though arguably an excessive intervention and interruption to the market, proved necessary to address the seriousness of the problems facing the government regulators. China must understand how to gradually build a sound and balanced framework that will prudently regulate and supervise the financial futures market and at the same time will promote an innovative and healthy financial futures market. However, because China's government policy and tight control over securities and futures market has been the norm in past decades, much remains to be seen how such a goal can be achieved successfully.

## X. CONCLUSION

The emergence and expansion of a commodity and financial futures market in China witnessed a rather problematic period in the 1990s in the wake of China's economic reform and development. The market was dominated by market manipulation, unauthorized trading by numerous futures firms, irregularities of various kinds and excessive speculation. Incidents involving serious market manipulation in the government bond futures market were the norm.<sup>367</sup> The futures market was a "big litigation family," generating a high rate of disputes and litigation.<sup>368</sup> The government's campaign from 1993 to 1999 to stop such a situation and halt the blind development of China's futures market led to a substantial reduction of futures exchanges, the cancellation of certain futures products, the suspension of offshore futures trading and the closure of government bond futures market. Arguably, this campaign and the resulting regulations were serious and excessive interventions and interruptions in the market. From the government's point of view, such conditions were not conducive to China's growth beyond a few experimental futures products in a limited number of futures exchanges. Given the seriousness of the problems, its impact on the financial market, on public confidence, and on the economy as a whole, the government's actions proved to be necessary to maintain social stability and public confidence in the fragile financial market.

China's lack of coherent and comprehensive regulation of the commodity and financial futures market in its early years contributed to the

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366. See The Notice on the Summary of the Meeting Implementing the Notice on Sternly Investigating & Dealing with Illegal Trading Activities in Foreign Exch. Futures & Foreign Exch. Deposit Trading, *supra* note 29; The Notice on Relevant Issues about Cancellation by Futures Broker Firms of Offshore Futures Bus., *supra* note 31; The Urgent Notice on Suspension of Trials of Gov't Bond Futures Trading, *supra* note 30.

367. SECURITIES REGULATION IN CHINA, *supra* note 68, at 121.

368. UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at Preface, 1.

frequency of problems. The 1999 Provisional Regulations and the four implementing rules provided an impetus to the standardization of China's new futures market. The State Council's 2004 Nine-point Opinion pointed out the future direction of reform: the widening and steady development of China's capital market to include the commodity and financial futures market.<sup>369</sup> The revised 2007 Regulations further implemented rules extending the securities and futures regulatory framework established by the 1999 Provisional Regulations and the 2005 Securities Law. The 2007 Regulations represent a step toward building a balanced regulatory framework for China's commodity and financial futures market. However, full operation of the regulatory system under the 2007 Regulations depends upon further development of regulation and clarification of open provisions. As a result, the framework remains subject to uncertain and confused application.

The past adjudication of futures disputes exhibited one guiding principle: issues should be dealt with fairly to correctly balance and protect the lawful rights and interests of the parties. The people's courts played their part by identifying each party's liability in the cases involving a firm's qualification to engage in futures trading,<sup>370</sup> defining the circumstances whereby futures exchanges or futures broker firms should be liable for losses in forced liquidations,<sup>371</sup> and allocating the responsibility of futures exchanges and the rights and obligations of futures exchanges.<sup>372</sup> Furthermore, the people's courts enforced the applicable international rules and practices for offshore trading of commodities or financial futures.<sup>373</sup>

The people's courts face disputes involving new and difficult issues concerning every stage of futures trading. It is not surprising that in earlier cases, the people's courts lacked judicial guidelines, regulations and rules, and were criticized for taking the wrong approach or for failing to understand the legal relationships involved in futures trading.<sup>374</sup> Based on

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369. Several Opinions of the St. Council on Promoting Reform, Opening-up & Steady Development of China's Capital Mkt., *supra* note 51.

370. See, for example, Zhongyuan Grain & Oil Trading Co. v. Zhumadian Region Yinfeng Co., discussed *supra* Part V and note 134.

371. The 2003 SPC Futures Judicial Provisions, *supra* note 7, at Art. 39.

372. See Hainan Zhongqing Jiye Dev. Ctr. v. Sichuan Pingyuan Indus. Dev. Co., discussed *supra* Parts V, VIII and note 276.

373. See Zhao Xiaomei v. Nanjing Jinzhongfu Int'l Futures Trading Co., discussed *supra* Part VII and note 255.

374. See EXPLANATION AND ANALYSIS OF TYPICAL CASES OF FINANCIAL LAW, *supra* note 141, at 247–48. In many of the early cases where a futures broker's qualification to trade was disputed, the people's courts always ruled in favor of the clients, ordering the futures brokers who had engaged in invalid trading to return lost deposits to the clients. Commentators criticized this approach for the lack of correct understanding by some people's courts of the legal relationship between the broker, clients and the complexities of futures trading. See also UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 333 (arguing the judgment of the Court of First Instance in *Hainan Zhongqing Jiye Dev. Center v.*

the 1986 GPCL and basic principles of contract law, the 1995 SPC Futures Judicial Guidelines formulated a comprehensive response to the problematic increase in futures disputes in the people's Court. Thereafter, the 2003 SPC Futures Judicial Provisions represented a unified understanding and approach to major civil law issues concerning futures market and disputes within the people's courts, between government regulators and inside the futures business industry.<sup>375</sup> Those judicial guidelines now serve to guide the local people's courts in their adjudication of commodity and financial futures market disputes.

China's emerging commodity and financial futures market has changed significantly since the establishment of the first commodity futures exchange in Zhengzhou in October 1990, through the establishment of the CFFEX in Shanghai in September 2006. These changes reflected a transition in establishing China's commodity and financial futures market and a regulatory framework that aligned with China's overall economic, legal and judicial reform, and in particular, the development of China's capital market. China's commodity and financial futures market in the early 1990s demonstrated how crucial an appropriate and balanced legal, regulatory and judicial framework is to ensuring a healthy and sustainable development of commodity and financial futures markets. Despite past government policy and the tight control over securities and futures markets, China's regulatory experiences will be instrumental to accomplishing this goal. The recent regulatory developments in the revised 2007 Regulations, such as the relaxation of a previous ban on financial institutions engaging in futures trading,<sup>376</sup> suggest that China is moving closer to building a well-suited and well-balanced legal, regulatory and judicial framework for its commodity and financial futures exchange markets.<sup>377</sup>

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*Sichuan Pingyuan Indus. Dev. Co.* for many reasons, including because the Court confused the futures exchange's civil liability for breach of contract with its administrative liability).

375. See UNDERSTANDING & APPLICATION OF THE 2003 PROVISIONS OF THE SUPREME PEOPLE'S COURT, *supra* note 75, at 19.

376. As opposed to Article 30 of the 1999 Provisional Regulations, financial institutions are not included under Article 26 of the 2007 Regulations on the Administration of Futures Trading. See The 1999 Provisional Regulations on the Admin. of Futures Trading, *supra* note 32, at Art. 30; see also The 2007 Regulations on the Admin. of Futures Trading, *supra* note 5, at Art. 26.

377. For discussion on China's securities regulation and the stages of development since 1980s, see SECURITIES REGULATION IN CHINA, *supra* note 68. See also ZHU SANZHU, SECURITIES DISPUTE RESOLUTION IN CHINA (Aldershot, England; Burlington, AV, USA: Ashgate, 2007). In particular, see ch. 1, *The Legal, Regulatory and Judicial Framework*, at 7-41 and ch. 7, *The Development of Securities Dispute Resolution in China*, at 197-231.