

FOCUS

CORPORATE GOVERNANCE FROM A COMPARATIVE PERSPECTIVE

BLOWING WHISTLE WITHOUT PROTECTION: CAN CHINESE REGULATOR AFFORD SENDING SHEEP AMONG WOLVES?

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This paper reviews the current legal framework of whistleblower protection in China. Before 2014, the laws and regulations operate without concrete protection measures for whistleblowers. The regulator of Chinese securities market issued a regulation to promote whistle blowing in combatting corporate and securities fraud in 2014, but it lacks clear and detailed rules to address the challenges presented in reality. This paper offers case studies and finds the current law does not prevent retaliation against whistleblowers either. Based on these case studies, this article points out the problems of the current legislation and offers advice for improvement.

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INTRODUCTION

A comparison between the police advice for citizens who encounter robbery in the U.S. and in China is telling on the governments’ expectations of citizens when they are facing a crime. The Metropolitan Police of the District of Columbia (“MPDC”), for instance, ask citizens not to resist and give up money:

If someone tries to rob you — don’t resist. Give up your property — don’t give up your life.¹

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¹ For similar police advice, see New York Police Department Personal Safety Tips (“If someone attempts to snatch your pocket book, let go of it, especially if there is a weapon involved.”), available at http://www.nyc.gov/html/nypd/html/crime_prevention/personalsafety.shtml (last visited Nov. 6, 2014).

The West District of Beijing Police Bureau (“WDBP”) has much more detailed advice. The police ask citizens to do the following:

1. *If the robber has attacked from behind and your neck is already held in the robber’s arms, turn aside and use your elbow to hit the robber’s belly, or step hard on his feet to force him let go of your neck; when his arms are loose, run away quickly;*
2. *If you encounter the robber rather face to face, approach the robber, use your knees to attack his vital (but if the robber is flexible or wearing a heavy jacket, do not do this);*
3. *If you have an umbrella or a hand stick with a sharp end, stab the robber with it; you can also make a V shape of your fingers to poke the robber’s eyes.*

And when the robber has a weapon such as a knife, the police advise citizens to:

1. *Keep a distance with the robber with a knife, and find an opportunity to kick his wrist to disarm him;*
2. *Take it from him when you are close and use it to subdue the robber;*
3. *Take the full advantage of the environment (for instance, use a loosen brick or a tile to hit the robber, or raise some dirt or sand at his eyes, or use your belt or a small knife to harm the robber);*
4. *If you figure the robber is too cruel and you cannot defend yourself, run away from him quickly; should you take this unfortunate option, you should run sideway to prevent attacks from behind; should the robber outrun you, lie on your back and start kicking nonstop to prevent the robber’s attacks, and if you are lucky, you may even kick the weapon off the robber’s hand.*

And if there are a group of robbers rather than one, the police suggest that:

You should attempt to beat the leader of the group to warn the rest of the villains.²

MPDC apparently is not so confident with its citizens’ ability to protect themselves and thus believe it is wise for them to just give up money without resistance.³ WDBP, in contrast, seems to be confident about the citizens’ ability to protect themselves, and thus it emphasizes

² For similar police advice in China, see Advice from the Police Bureau of Xinfu District of Xinzhou City, available at <http://www.xzgabmfw.gov.cn/010904/public/showinfo.aspx?id=2013022815035983780109> or Wutai County Police Bureau Advice for Citizens Encountering Robbery, available at <http://www.xzgabmfw.gov.cn/010904/public/showinfo.aspx?id=2014012623163092370109> (last visited Nov. 6, 2014).

³ The self-defense measures that MPDC advises, including running away, hiding, screaming, raising an alarm and so on, are by no means for citizens to resist the criminal.

more on combating the criminals, or catching the criminals with citizens' heroic help.

The difference in the expectation of the citizen's reaction to a wrongdoing seems to be reflected in the two countries' securities regulations. In the U.S., a special legislation is passed to make sure that when an individual (or more) provides information relating to a violation of the securities laws, or "blows the whistle," no employer may discharge, demote, suspend, threaten, harass, directly or indirectly, or in any other manner discriminate against him (or them).⁴ While the U.S. regulator strives to protect the whistleblowers, Chinese legislator seems to be indifferent to the potential sufferings of the whistleblowers. Chinese legislator does little for the whistleblowers' safety. In China, there are some vague regulations that prohibit retaliation from the employer, few feasible legal actions could be filed based on them. Whoever reports the violation is supposed to protect himself, should he chooses to carry on that mission in China.

Just like the police advice to fight the robber does not likely to discourage robbery, the Chinese regulator's calling for whistleblower's heroic actions does not generate tips leading to successful investigations or suppress the violations of securities regulation. This surely cannot be good policy choice given China's corporate fraud epidemic and weak governmental securities regulation regime. It is common sense that anyone who blows the whistle threatens those in power and those who are able to retaliate. China is no exception. Through analyzing the current legal framework of whistleblower protection and reviewing some high-profile whistleblower cases, this article argues that the inadequate protection of the whistleblowers renders China's securities regulations ineffective and increases regulatory costs.

The rest of the paper is organized as the following. Part II reviews the current legal framework; Part III reviews a few cases involving whistleblowers that have led to successful enforcement actions and resulted in the sanctions of listed companies; Part IV discusses these cases, and based on the discussion this article also points out the problems of the current legislation and offers some policy advice for improvement.

I. THE CURRENT LEGAL FRAMEWORK OF CHINA'S WHISTLEBLOWER PROTECTION

Encouraging whistle blowing is a widely used regulatory technique that counties rely on to foster compliance in securities market. To implement such regulatory technique, the protection of whistleblower is indispensable. In China, the Criminal Procedure Law specifically provides some legal protection for whistleblowers across the public and private sectors.⁵ For the reporting of corporate and securities fraud, the legal measures for

⁴ See Section 922 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"), which amended the Securities Exchange Act of 1934 (the "Exchange Act") by, among other things, adding Section 21F, entitled "Securities Whistleblower Incentives and Protection."

⁵ Pattie Walsh, *Whistle Blowing: An employer's Guide to Global Compliance* (DLA Piper, 2013) 13, available at <http://www.dlapiperuknow.com/export/sites/uknow/products/files/uknow/DLA-Piper-Whistle-blowing-Report.pdf> (last visited Nov. 6, 2014).

protecting whistleblower can be found in: (1) the internal accounting control regulations; and (2) the specific regulations on whistle blowing.

The internal accounting control regulations include two major legislations: the Accounting Standards for Business Enterprises (1998) and the Basic Standard for Enterprise Internal Control (2009). The Accounting Standards for Business Enterprises requires companies to report actual transactions and their accounting information true, reliable, complete and consistent with the cash flow, financial and operation situations based on actual transactions. The Basic Standard for Enterprise Internal Control, as a ministerial level regulation issued jointly by the Ministry of Finance, China Securities Regulatory Commission (CSRC), the National Audit Office, China Banking Regulatory Commission and China Insurance Regulatory Commission, intends to increase the effectiveness of internal controls in Chinese listed companies and thus it requires companies to set up systems to receive information from whistleblowers in order to enhance the internal communication.⁶

But these two regulations only serve to provide the basis for whistleblowers to be legally recognized. Only when they are combined with the labor protection measures provided by labor laws can the laws offer protection to whistleblowers.⁷

The *Labor Contract Law*, the *Labor Dispute Resolution Law* and the *Labor Law* both aim at promoting labor protection by requiring the signing of labor contract with employees and forbidding of ending the contract without proper cause. The *Labor Contract Law* set as a general principle that all employers should sign labor contract with their employees. According to the *Labor Contract Law*, the contractual relationship exists even if the employer has not actually signed a contract on paper.⁸ In principle, the

⁶ See the relevant article of the Basic Standard for Enterprise Internal Control below:

Article 43 An enterprise shall establish proper complaints handling and complainant protection policies, set up a complaints hotline, clearly define its complaints handling procedures, response time and resolution requirements, in order to provide an effective channel for dissatisfied interested parties to report and address their complaints.

Complaints handling and complainant protection policies shall be communicated to all members of staff in a timely manner.

⁷ R. Beller, *Whistleblower Protection Legislation of the East and West: Can It Really Reduce Corporate Fraud and Improve Corporate Governance — A Study of the Successes and Failures of Whistleblower Protection Legislation in the US and China*, 7 *New York University Journal of Law & Business*, 873 (2010).

⁸ See the relevant article of the Labor Contract Law below:

Article 10 A written Labor Contract shall be concluded in the establishment of an employment relationship.

Where an employment relationship has already been established with an employee but no written Labor Contract has been entered simultaneously, a written Labor Contract shall be concluded within one month from the date when the employee begins to work.

Where an employer and an employee conclude a Labor Contract prior to the employment, the employment relationship is established from the date when the employee begins to work.

employer cannot terminate the labor contract unilaterally.⁹ If an employer unilaterally terminates the labor contract without satisfying the legal conditions, the employee may seek legal remedies in court and in labor arbitration.¹⁰ The *Labor Dispute Resolution Law* provides a clear procedure for handling labor contract disputes, thus providing a foothold for whistleblowers to be protected through formal legal procedure.¹¹ In addition, the

⁹ See relevant articles of the Labor Contract Law below:

Article 36 An employer and an employee may dissolve the labor contract if they so agree upon negotiations.

Article 39 An Employer may terminate the labor contract if the employee:

- (1) fails to meet the requirements for employment during the probation period;
- (2) materially breaches the Employer's rules and regulations;
- (3) causes substantial loss to the Employer due to his serious dereliction of duty or engagement in graft for personal gain;
- (4) establishes an employment relationship with another Employer simultaneously which materially affects the completion of his task with the original Employer, or he refuses to rectify the situation after being cautioned by the Employer;
- (5) causes the labor contract to be invalid due to any of the circumstances stipulated in item (1) of the first paragraph of Article 26 of this Law; or
- (6) is subject to criminal liability in accordance with the law.

Article 43 If an Employer is to terminate a labor contract unilaterally, it shall first inform the labor union of the reasons. The labor union shall have the right to demand that the Employer make the necessary adjustment if the Employer violates laws, administrative regulations or the labor contract. The Employer shall consider the opinions of the labor union and notify the labor union in writing of the outcome of its handling of the matter.

Article 44 A labor contract is terminated if:

- (1) the contract term expires;
- (2) the employee has started to enjoy his entitlement to basic old-age insurance pension in accordance with the law;
- (3) the worker is deceased, or is declared dead or missing by a people's court;
- (4) the Employer is declared bankrupt in accordance with law;
- (5) the Employer has its business license revoked, is ordered to close or is closed down, or the Employer decides on early dissolution; or
- (6) other circumstances stipulated by laws or administrative regulations arise.

¹⁰ See relevant articles of the Labor Contract Law below:

Article 48 If an Employer terminates or ends a labor contract in violation of this Law and the employee demands continued performance of such contract, the Employer shall continue performing the same. If the employee does not demand continued performance of the labor contract or if continued performance of the employment contract has become impossible, the Employer shall pay the employee compensation in accordance with Article 87 hereof.

Article 87 If an employer violates this Law by dissolving or terminating the labor contract, it shall pay compensation to the employee at the rate of twice the economic compensations as prescribed in Article 47 of this Law.

¹¹ See relevant articles of the Labor Dispute Resolution Law below:

Article 4 Where a labor dispute arises, a laborer may have a consultation with the employing unit or request the labor union or a third party to have a consultation with the employing unit in order to reach a settlement agreement.

Article 5 Where a labor dispute arises, the parties are not willing to have a consultation, the consultation fails or the settlement agreement is reached but not performed, an application for mediation may be made to an mediation institute. Where the parties are not willing to mediate, the mediation fails or the mediation agreement is reached but not performed, an application for arbitration may be made to the labor dispute arbitration commission. Where there is objection to the arbitral award, litigation may be initiated to a people's court unless otherwise specified herein.

Labor Law authorizes government agencies to supervise employers for the protection of the employee's rights, and it provides that the labor administrative departments and other authorized agencies could impose certain administrative penalty to employers who are found having violated the law.¹² These provisions may offer protection to whistleblowers, but it is generally agreed that whistleblowers in China still face retaliation from their employers and lack sufficient legal protection.¹³

The regulation that is designed specifically to encourage whistle blowing and to protect whistleblowers from retaliation, *Interim Provisions on Reporting Securities and Futures Violations by Whistleblowers (2014 Interim Provisions)*, issued on June 26, 2014 by the CSRC.¹⁴ The *2014 Interim Provisions* specifically provides that those who retaliate against whistleblowers should be liable in accordance with relevant laws.¹⁵

¹² See the relevant article of the Labor Law below:

Article 101 The employer that unjustifiably prevent labor administrative departments and other relevant departments as well as their workers from exercising supervision and inspection powers or retaliates informers shall be fined by labor administrative departments or other relevant departments. If a crime is committed, the person in charge shall be brought to hold criminal responsibilities.

¹³ Some recent cases demonstrate the difficulty of protecting whistleblowers from the employer's retaliation. In August 2014, the Shenzhen Walmart facility fired four employees after they had revealed to the public media that a branch of Walmart store was selling meat after the expiration date, recycled cooking oil, and rice with insects. The employer claimed that the decision to fire the four employees was made on the basis that they violated the company rules and they brought damage to the company. A similar case happened in 2008, when Yunnan Power Biological Products Group terminated its labor contract with 29 employees after they had signed a report about tax fraud of the company. The corporate official claimed that the decision was "in accordance with company rules." In 2007, Mr. HUANG reported corruption and insider dealing of Shanghai Everstar Online Entertainment Co. Ltd. He was fired by the company because of "serious violations of the company discipline rules." These cases were reported by public media, but few employees chose to seek legal remedy despite of the retaliation. Among those who did apply for labor dispute arbitration, many failed. It is not easy for whistleblowers to protect themselves with labor law. See Amanda Hitt, *Walmart Whistleblower Case in China Highlights Global Issue*, Sep. 18, 2014, available at <http://www.foodwhistleblower.org/walmart-whistleblower-case-in-china-highlights-global-issue> (last visited Nov. 4, 2014); LI Junjie, 巨额税案迷局: 云南力量公司员工举报可能被解聘报复 (*Whistleblowers may be fired out of retaliation*), Jul. 8, 2008, available at http://finance.ifeng.com/news/industry/corporate/200807/0708_2237_640419.shtml (last visited Nov. 4, 2014); ZENG Yuyan, 公司员工举报领导涉嫌贪污腐败几天后遭遇解雇 (*Employee Got Fired After Reporting on Corruption*), Dec. 24, 2007, available at <http://news.sohu.com/20071224/n254252057.shtml> (last visited Nov. 4, 2014)

¹⁴ The full text of "Interim Provisions on Reporting Securities and Futures Violations by Whistleblowers, see http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201406/t20140627_256848.html (last visited Nov. 6, 2014).

Earlier, CSRC had set up the "12386" hotline for complaints and whistle blowing. See CSRC, Sep. 16, 2013, available at http://www.csrc.gov.cn/pub/newsite/tzzbh1/tbgzdt/tbjgbm/201310/t20131016_236373.html (last visited on Nov. 6, 2014).

¹⁵ See the relevant article of 2014 Interim Provisions below:

Article 21 Whoever retaliates against a whistleblower, or deliberately fabricates facts, forges evidence, or brings false charges against or frames up any other person under the guise of tip-off shall assume legal liability in accordance with the law.

The whistleblower protection provided by Chinese law is general and abstract. Neither the legal remedies are provided in law, nor applicable judicial standards are set by the courts. When a whistleblower faces retaliation, such as employment termination, it is not clear whether the whistle blower should prove that whistle blowing was a “contributing factor” in the retaliation, or a “but for” causation typically required by tort law, or “motivation factor” applied in the mixed-motive discrimination cases. To realize the rights provided in the existing Chinese laws, the effectiveness of the new regulation — the *2014 Interim Provisions* — still needs time to prove. But judging from the general ineffectiveness of the whistleblower protection provided in the labor law, much work needs to be done to make the regulation successful.¹⁶ I will discuss some of the practical challenges that the *2014 Interim Provisions* may encounter in the following parts.

II. CASE STUDIES

This part reviews four cases that have led to successful enforcement actions and resulted in the sanctions of listed companies. In all these cases, whistleblowers have faced retaliation and the law has provided little protection. Since these cases took place before the *2014 Interim Provisions*, what the whistleblowers could rely on was the accounting control and labor protection legislations. As these cases show, although protecting whistleblowers is in principle uncontroversial in China, in practice it is almost certain that the whistleblowers cannot rely on them to prevent the retaliation. Even if the wrongdoers are all brought to justice, whistleblowers inevitably suffer from retaliation and they have to take self-help measures that are not offered in law.

Case 1: The “Dark Side” of the Securities Investment Funds

By the year 2000, with the expansion of the securities investment funds in China they had gradually become the most influential institutional investor in the capital market. On October 8, 2000, *Caijin Magazine* published a report alleging massive market manipulation and insider trading of the securities investment funds. The reporters managed to acquire an internal report from the Shanghai Stock Exchange (SSE) by an analyst named ZHAO Yugang.¹⁷

The report examined the market activities of more than twenty investment funds

¹⁶ Media comments on the 2014 Interim Provisions focus on the financial reward scheme it establishes, but little on the protection of whistleblowers from retaliation. For instance, SONG Yixin from Shanghai New Wang Wen Law Firm, says in an interview that “China’s stock market is neither heavy penalties, nor rewarded.” He believes that to combat economic crimes the award paid for whistleblowers should not be capped. ZANG Xiaoli from Beijing Yingke Law Firm believes that the amount is appropriate, as huge rewards may lure individuals to exaggerate or fabricate facts for the reward. See *CSRC Is Questioned of the Function of Rewarded Whistleblowers*, Jun. 27, 2014, available at http://hn.isvoc.com/201406301351-securities-and-futures-commission-started-to-report-violations-to-be-paid-questioned-the-limited-role.html#_Fib4UtY9hY (last visited Nov. 4, 2014)

¹⁷ HU Ping & LI Qing, 基金黑幕——关于基金行为的研究报告分析 (*Behind the Fund’s Dark Curtain: Analysis of a Research Report on Fund*), *Caijing*, Oct. 2000.

operated by 10 securities companies, and it found the following facts that the regulator had never paid attention to: First, rather than making long-term investment, these investment funds tended to change their positions more than average market participants; second, the funds that were managed by the same company were found coordinating among themselves to set up large holdings and trade stock among themselves to create the appearance of robust demand at high prices; third, these funds often invested in the shares when the security firms were underwriters of an initial public offering; and finally, information disclosed by these funds fell far short of regulatory requirements.¹⁸

The Caijing report was praised as the most important report on misbehaviors in the securities market of the decade, and the report promoted the development of the regulatory system. However, despite the public recognition of its value, the contributors of the report, including the whistleblower ZHAO Yugang from SSE were under severe pressure. Little help was given to protect them, and ZHAO Yugang eventually received an internal discipline for passing the internal report to the media. The reason given to the public was that he disclosed internal information sought through work without authorization, which was against the *Regulations on Guarding Secrets of SSE*.¹⁹

Case 2: The Lantian Co. Case

In October of 2001, LIU Shuwei, a researcher from Central University of Finance and Economics, published a 600-word article on a special periodic financial report that was solely for senior government officers. The article provided clear analysis on the finance of Lantian Co., a listed state-owned company closely connected with the Ministry of Agriculture, and concluded that the accounting was problematic by analyzing its three major financial indicators: liquidity ratio, quick ratio, and net working capital. She also warned the banking sector that Lantian Co. might not be able to collect its loans.

After discovering the article, the chairman and vice chairman of Lantian Co.'s board immediately tracked down LIU and visited her in her home, reproaching her of killing Lantian Co. and requesting her to retract the article. After LIU's refusal, Lantian Co. immediately sued LIU for libel, and claimed 500,000 yuan RMB for damage. LIU also received death threat letters after receiving the subpoena. Thus she reached out to the public media, disclosing further analysis pointing to fraudulent activities of Lantian Co. With the journalists' investigative reports and the outcry from the individual investors, the police stepped in to investigate Lantian Co., which was eventually found guilty of all the disclosed fraudulent activities. In 2002, the corporate executives of Lantian Co. were arrested, and the lawsuit against LIU was dismissed.²⁰

Case 3: Sichuan Changhong Co. Case

¹⁸ B. Naughton, *The Politics of the Stock Market*, 3 China Leadership Monitor 1, 3 (2002).

¹⁹ LU Xiaoping, 基金黑幕另一主角北大才子赵瑜纲离开上交所 (*One of the Protagonists in the "Behind the Fund Curtain" Affair Has Left the Shanghai Stock Exchange*, Caijing shibao, Jul. 6, 2001).

²⁰ ZHOU Pengfeng and CHEN Junling, 刘姝威: 六百真言击碎“蓝田神话” (*LIU Shuwei: Six Hundred Words' Truth Piercing the "Lantian Myth"*), available at http://www.china.com.cn/economic/txt/2010-12/16/content_21556293.htm (last visited Sep. 27, 2014).

On January 25, 2010, a former Changhong employee FAN Dejun, for the third time, filed a report to the Sichuan Branch of CRSC, stating that Changhong Co. committed accounting fraudulent in 1998. FAN was previously convicted of embezzlement during his work in Changhong Co., and was sentenced imprisonment for 7 years. (FAN actually served for 5 years.)

In the report filed by FAN on April 8, 2010, FAN pointed out several problems and requested further investigation on them.²¹ FAN claimed that the financial report that Changhong filed to CSRC contained fraudulent information and should be investigated for tax evasion. In the report Changhong double counted its 2 billion yuan revenue of the year 1998, and Changhong's recorded 300 million yuan on advertisements was fraudulent; Changhong did not record loss for clearing all the 100 thousand TV sets in stock, and the loss would be more than 100 million yuan at least; Changhong's acquisition of the colored picture tube (CPT) in 1998 led to a 2.2 billion yuan loss, which was not reflected in the report.

On May 20, FAN was arrested again by the police, which was investigating FAN again with the help of Changhong Co. Changhong Co. offered evidence that FAN had forged value-added tax invoices in 1998. He was convicted and sentenced to 10 years' imprisonment in the trial.²²

Case 4: Changzheng Electric Co. Case

From the end of 2005, a former employee of Guizhou Changzheng Electric Corporation LI Jiebin disclosed the company's accounting fraud to the public, and also reported the wrongdoing to the CSRC. LI reported two major facts. First, the actual annual revenues of Chang Zheng Electric Corporation for 2003 and 2004 were 120 million and 130 million yuan respectively, but the reported revenues were 150 million and 200 million yuan respectively. Second, the association between the company's first and third largest shareholders were not reported. LI provided concrete evidence on the alleged wrongdoings, such as the company's forged sales contracts and the accounting book with manipulated profit numbers, to media.²³

On January 9, 2006, LI and his lawyer YAN Yiming filed complaint to the CSRC. CRSC conducted a short investigation and claimed that there was no fraudulent activity as claimed by YAN and LI.

Shortly after YAN and LI's report, Guizhou Changzheng Electric Corporation sued

²¹ These can be found from FAN Dejun's blog site. See FAN Dejun, 关于四川长虹电器股份有限公司虚假财务报告和欺诈发行举报具体调查情况说明(*Explanations of Reporting of False Accounting Statement and Fraudulent Issuance of Changhong Co. Ltd.*) Apr. 24, 2010, available at http://blog.sina.com.cn/s/blog_51b351ab0100i9w5.html (last visited Sep. 27, 2014)

²² LUO Haitao, 长虹范德均十年战未休 (*Ten Years' Battle Between FAN Dejun and Changhong Co.*), available at <http://finance.sina.cn/?sa=d4083269t74v39&sid=126128&vt=3&wm=4002> (last visited Nov. 1, 2014).

²³ HE Jun, 长征电器事件深喉首次曝光 (*First Deep Exposure of Changzheng Electrics Incident*), available at <http://finance.qq.com/a/20060117/000497.htm> (last visited Nov. 1, 2014).

YAN Yiming for libel, seeking 300 million yuan for damage of reputation. Although the litigation was clearly for retaliation, few legal measures could YAN or LI rely on to protect themselves.²⁴ However, with the public media's questioning the nature of the litigation, Guizhou Changzheng Electric Corporation eventually dropped the lawsuit in April 2007.²⁵

III. CAN CHINA AFFORD SENDING SHEEP AMONG WOLVES?

The four case studies offer us an opportunity to test what *2014 Interim Provisions* could bring if it is applied to real-life situations that whistleblowers may face. Although the legislation of the *2014 Interim Provisions* bears much hope of the policy maker and the investors, compared with the previous regulations, it offers few concrete measures to protect whistleblowers. None of its provisions mandates the government agencies to offer protection. None allows the whistleblower to file an anti-retaliation action against the wrongdoer. Furthermore, in the following situations where whistle blowing takes place, the *2014 Interim Provisions* might serve not to encourage but to discourage it:

where the whistleblower's report is based on the information from the work of a third-party, who, in providing the information, is possibly in violation of his or her obligations to the employer;

where the whistleblower's report is publicized and the company that allegedly violated Securities and Futures regulations threatens to sue the whistleblower for libel;

where the whistleblower is an employee of the company that allegedly violated Securities and Futures regulations, and is involvement in the violation(s) due to the nature of the employment.

The *2014 Interim Provisions* offers monetary incentive for whistleblowers, but the several limits set by Article 14 show that in all these situations whistle blowing is not incentivized. According to Article 14 of the *2014 Interim Provisions*:

In the following situations whistleblower cannot receive monetary reward: ...3. if the violation has been publicized by media, internet media, etc.; 4. if the whistleblower himself/herself is involved in the reported violation; and 5. if the whistleblower is employed by a government agency, and the information that the whistleblower relies on comes from

²⁴ In a comment published on an influential financial media, Professor WANG Yong from the Law School of China University of Political Science took this case as a typical case of retaliation against the whistleblowers. He further commented that if whistleblowers were retaliated without proper institutional protection, there would be a chilling effect for potential whistleblowers. See WANG Yong, 如何保护内部举报人 (*How to Protect the Whistleblowers*), available at <http://finance.ifeng.com/stock/special/scchcw/20100531/2252561.shtml> (last visited Nov. 1, 2014)

²⁵ YAN told the media that that the public support that the media helped him to gain was vital for Guizhou Changzheng to drop the suit. YAN said, "I think the result is cheerful. As a lawyer I was once deprived of the rights of rejoinder, which made me really indignant. The results today would not take place without the support of the media." available at http://bbs.hexun.com/stock/post_5_2838657_1_d.html (last visited Nov. 1, 2014)

the government work; or if the whistleblower receives the information from a government employee whose work produced the information;”

In the Caijing reporting case, neither the reporter nor the analyst could receive monetary reward because the information was from a government employee whose work produced the information. The whistleblowers from Sichuan Changhong Co. Case and Changzheng Electric Co. Case would be deprived of monetary reward for their own involvement in the corporate fraud. The whistleblower from the Lantian Co. Case as well as other cases is discouraged to publicize the wrongdoing on media, but doing so in practice is perhaps the only viable way of self-protection and the only effective deterrence available against the coming retaliation.

The *2014 Interim Provisions* has an article on reducing the punishment of the whistleblower. Article 19 provides that if the whistleblower himself/herself is involved in the violation, the punishment may be lenient, commuted, or waived. But given criminal investigation is often a means to retaliate the whistleblower, as is shown in Sichuan Changhong Co. Case and Changzheng Electric Co. Case, the provision might not be utilized at all, as has been shown in the happenings of the whistleblowers.

Fundamentally, the failure to design effective regulations in the *2014 Interim Provisions* is from the legislator’s insufficient understanding of the regulatory goals. The need for whistleblower protection is not only to handle existing violations, but more importantly, to construct better corporate governance. Chinese securities market is flooded with listed firms controlled by one majority shareholder, whose undue influence often causes fraudulent accounting and other illegal activities. It would be very difficult for regulators to correct these wrong-doings without whistleblowers help. In offering clear rules and concrete measures of protection to the whistleblowers, the regulator can better discipline the dominant shareholder as well as corporate management, for such rules could reduce the incentive of potential violators by increasing their risk of being exposed.²⁶

The weaker ones need divine protection if “sending sheep among wolves” takes place. If protection is needed for whistleblowers to ensure the effectiveness of regulation, the

²⁶ This can be viewed from the perspective of restructuring the private ordering of China’s listed firms. In their discussion on the private ordering, Professors Hart and Sacks wrote:

Every society necessarily assigns many kinds of questions to private decision, and then backs up the private decision, if it has been duly made, when and if it is challenged before officials. Thus, private persons are empowered, by observance of a prescribed procedure, to oblige themselves to carry out certain contractual undertakings, and, if dispute arises, to settle their differences for themselves. So may a host of other matters be settled which are immediately of private, but potentially of public, concern. In a genuine sense, these procedures of private decision, too, become institutionalized.

An understanding of how they work is vital to an understanding of the institutional system as a whole.

See H. Hart & A. Sacks, *The Legal Process: Basic Problems in the Making and Application of Law*, Foundation Press, (1958).

A definition of private ordering attributed to Professor Fuller is “law” that parties bring into existence by agreement. On the continuity between the social processes of negotiation and adjudication, see Eisenberg, *Private Ordering through Negotiation: Dispute-Settlement and Rule-Making*, 89 Harvard Law Review, 637 (1976).

government should provide such regulation. Otherwise, whistleblowers would be kept from whistle blowing in fear of retaliation. For the regulator, it is clearly impractical to expect the weak insider's heroic actions absent concrete measures of whistleblower protection. No meaningful protection for whistleblowers creates a culture of silence,²⁷ which would not be consistent with the regulatory goals such as to deter wrongdoings or to improve corporate governance in Chinese listed firms.

CONCLUSION

Prior to 2014, the Chinese regulations on whistleblower protection operates at a high level of generality and abstraction, with limited evidence of concrete protection measures emerging. Although the *2014 Interim Provisions* shows Chinese regulator's intention to promote whistle blowing in combating corporate and securities fraud, it lacks detailed rules to address the challenges presented in real-life situations. Without such rules, whistleblowers have to expose themselves fully to potential retaliation. The protection for whistleblowers therefore has not improved much.

In making the *2014 Interim Provisions*, the Chinese regulator apparently has learned from foreign practices such as those in the U.S. The several limits set by the legislator on the financial reward for whistleblowers are similar to the regulations in the U.S.²⁸ These foreign practices were often contemplated to balance the needed optimal information flows and to maintain the decision-making structures within the corporation.²⁹ In the U.S., as Professor Jennifer Arlen and Reinier Kraakman point out, such balance is set to achieve (1) inducing efficient activity levels and (2) minimizing the joint costs of misconduct and enforcement.³⁰ The Chinese regulator, however, has not set the regulatory goals and carefully consider fine-tuning the regulation accordingly. Without such careful consideration, it is easy for a well-intended regulation to fail its mission.

The Chinese regulator has an abstract statement on the regulatory goals of the *2014 Interim Provisions*. Article 1 of the *2014 Interim Provisions* states that "for the purpose of safeguarding the rights of individuals and entities to report violations of securities and future laws, to provide proper procedures for reporting, and to increase the force to

²⁷ As a commentator points out, "only if the good intentions of any law are matched by a change in culture can a safe alternative to silence be created." See Guy Dehn and Richard Calland eds. *Whistle Blowing around the World: Law, Culture and Practice*, IDASA publisher, (2004).

²⁸ See Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Subtitle B Increasing Regulatory Enforcement and Remedies, available at <https://www.sec.gov/about/offices/owb/dodd-frank-sec-922.pdf> (last visited Nov. 3, 2014).

²⁹ Ronald J. Daniels & Robert Howse, *Rewarding Whistleblowers: The Costs and Benefits of an Incentive-Based Compliance Strategy*, in Ronald J. Daniels & Randall Morck eds. *Corporate Decisionmaking in Canada* (Calgary), 525–49 (1995).

³⁰ Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 *Yale Law Journal* 857, 863–65 (1984).

intensify the crackdown of illegal activities prohibited by securities and future laws.” But these goals are too general to be applied practically. Rather than being satisfied with an abstract statement, the regulator should ask some more down-to-earth questions: (1) Does the regulation encourage employees to report misconduct? (2) does the regulation protect them from retaliation if they do report? and (3) has the whistleblowers’ report properly assessed and, if necessary, has the regulator actioned upon the report?

A recent report on whistleblower protection Laws in G20 countries (including China) suggests that countries should focus on making, among others, “clear rules for when whistle blowing to the media or other third parties is justified or necessitated by the circumstances.”³¹ This is consistent with the findings from the case studies of this paper. This article suggests that the Chinese regulator should amend the *2014 Interim Provisions* to encourage whistle blowing based on the information from the work of a third-party, to encourage reporting fraud through public media, and to reward whistleblowers despite the whistleblowers’ own involvement in the reported fraud. With these measures, a better whistleblower protection scheme can be achieved, and the regulator can expect to change the cultural of silence and receive more tips from whistleblowers to combat securities market scandals.

³¹ See Simon Wolfe, Mark Worth & Suelette Dreyfus et al, *Whistleblower Protection Laws in G20 Countries Priorities for Action*, available at http://www.griffith.edu.au/__data/assets/pdf_file/0010/647542/FINAL_-_Whistleblower-Protection-Laws-in-G20-Countries-Priorities-for_-_Action.pdf (last visited on Nov. 3, 2014).