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Mergers & Accusations: Chinese Auditing and Corporate Disclosure Standards Indirectly on Trial in the United States

Janelle A. McCarty

Note

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In 2011, U.S. courts experienced a sudden rise in class action litigation from shareholders of U.S.–listed Chinese companies, primarily claiming violations of disclosure duties emanating from false information regarding finances and operations in China.[1] These Chinese companies entered the U.S. market through a reverse merger, a transaction where a primary company merges with a listed U.S. shell company.[2] This is a relatively inexpensive and fast method of entering the U.S. public markets. Chinese companies are not the only companies that utilize this transaction to enter the public market, but they are the only group that has shareholders turning to the courts with claims of fraud, consistently in the reverse merger context.[3] These Chinese reverse mergers ("CRMs") accounted for 25.5% of all class action filings in the

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1. *See* CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS 2011 MID-YEAR ASSESSMENT 1, 13 (2011).

2. *See generally* Gariel Nahoum, *Small Cap Companies and the Diamond in the Rough Theory: Dispelling the IPO Myth and Following the Regulation A and Reverse Merger Examples*, 35 HOFSTRA L. REV. 1865, 1902–09 (2007) (describing the reverse merger transaction).

3. *Compare* Helen Luk, *Sneaking In Through the Back Door*, THE HONG KONG INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS (May 14, 2011), http://app1.hkicpa.org.hk/APLUS/1105/pdf/mergers.pdf, *with* Henning Mennenoeh, Peter Kohl & Wolfgang Kircher, *Reverse Mergers Between German and US Biotech Companies*, 8 BIO-SCIENCE L. REV. 131, 131 (2006) (discussing the use of reverse mergers by German biotech companies without any mention of fraud).

first six months of 2011,[4] and the Securities and Exchange Commission ("SEC") has since issued an investor warning bulletin advising people against investing in these companies.[5]

U.S.–listed Chinese companies bring with them financial information for disclosure from operations in China, raising an array of accounting and auditing difficulties for auditors in the United States, and often fraudulent information is able to pass undetected. Shareholders need to be able to rely on accurate corporate disclosures in order to make decisions based on the actual market price of publicly traded shares.[6] If shareholders are not able to rely on that information, the foundation of the U.S. securities market is harmed. Currently the only solution available for injured shareholders is litigation: a very constrained ex post solution that is not likely to result in suitable remedies for shareholders.[7] Given the rise in CRM transactions[8] and the continuing economic relationship between China and the United States it seems likely that there will continue to be an increase in CRMs involving shell companies. Therefore, preventative action needs to be created to address this type of fraud before it enters the market.

In order to maintain the integrity of the U.S. securities market there needs to be an ex ante solution and infrastructure in place to properly review the information provided by the Chinese company upon merger with a U.S. shell. Such a solution will involve cooperation between the Chinese and American executive or judicial systems.

No concrete recommendations for an ex ante solution have been suggested. While reverse mergers are not treated the same as classical mergers when it comes to competition law, a bilateral agreement between China and the United States could utilize China's recent competition laws as a foundation

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4. *See* CORNERSTONE RESEARCH, *supra* note 1, at 1.

5. *See* SEC Off. of Investor Educ. & Advoc., Investor Bulletin: Reverse Mergers 4 (2011), http://www.investor.gov/sites/default/files/Reverse-Mergers.pdf.

6. *See* Christian J. Meier-Schatz, *Objectives of Financial Disclosure Regulation*, 8 J. COMP. BUS. & CAP. MARKET L. 219 (1986) (stating that the traditional purposes of financial corporate disclosure are investor protection, market efficiency and corporate governance, with other broad public policy considerations).

7. *See, e.g.*, Luk, *supra* note 3, at 18.

8. *See* Research Note, PCAOB, Activity Summary and Audit Implications for Reverse Mergers Involving Companies from the China Region: June 1, 2007 to March 31, 2010, 2 (Mar. 14, 2011), http://pcaobus.org/Research/Documents/Chinese_Reverse_Merger_Research_Note.pdf.

for further regulation. China's competition laws currently contain regulations involving a thorough review of merging companies.[9] Yet while competition laws in the United States and China converge, accounting and audit regimes between the two countries remain divergent in practice.[10] A bilateral agreement should be written to establish procedures necessary to ensure accurate information is conveyed to the U.S. market. While this solution combines different areas of law, and plays with novel concepts mixed with commonly considered international legal improvements, it raises interesting methods of solving a problem that is currently without adequate remedy.

Part I of this note will introduce the reverse merger transaction, discuss how it has been problematic for the SEC and the China Securities Regulatory Commission ("CSRC") to regulate, and examine the use of international agreements as a vehicle for a solution to the fundamental auditing problem in CRM transactions. Part II will analyze why the SEC and the CSRC are unable to sufficiently administer a solution to the CRM problem, as well as why international investment treaties are not likely to succeed. Part III will recommend that the World Trade Organization ("WTO") enact an international competition law, followed by a bilateral agreement between China and the United States directly targeting the root of the problem: Chinese auditing and corporate disclosure standards.

I. CRMS, FRAUD, AND THE ROLE OF INTERNATIONAL LAW

Reverse mergers are a useful tool for firms wishing to enter the public market; however, increasingly these transactions are looked at with suspicion based on fraudulent accounting concerns. The SEC has tried, unsuccessfully, to combat this,[11] leaving shareholders in the United States with few options. These transactions oftentimes escape review in China as well.[12] Even when audited, these transactions remain suspect based on the quality and poor enforcement of the regulations currently in force in China.[13] Domestic initiatives alone seem

9. *See* OWEN NEE & JINGZHOU TAO, MERGERS & ACQUISITIONS: BUSINESS LAWS OF CHINA 90–91 (2010).

10. *See, e.g.*, Research Note, *supra* note 8 at 6–8 (reporting that there has been 159 CRMs from January 1, 2007 to March 31, 2010 with capitalization of $12.8B).

11. *See* CORNERSTONE RESEARCH, *supra* note 1, at 1.

12. *See* Jay Zhe Zhang, *Securities Markets and Securities Regulation in China*, 22 N.C. J. INT'L L. & COM. REG. 557, 560 (1996–1997).

13. *See id.* at 561–63.

insufficient, thus international forums and the use of international agreements are examined, specifically in the area of competition law, as this may be the best place to turn for a solution.

A. CRM INTERACTION WITH THE U.S. MARKET

Chinese private firms looking to go public have global market options, including mainland markets, Hong Kong, and Europe,[14] but many choose to enter U.S. equity markets due to the size and stability of these markets.[15]

There are two options for companies seeking to enter U.S. public markets: an initial public offering ("IPO") or a reverse merger.[16] An IPO is a very time consuming and costly process.[17] IPOs have decreased as investors are reluctant to purchase IPO stock, and companies are deterred by the high cost of not only entering the market but also paying ongoing regulatory compliance costs.[18] A reverse merger, on the other hand, is a cheaper and faster method of entering the public market through the back door.[19] A reverse merger, also known as a reverse takeover, is not an illegal transaction nor is it inherently problematic.[20] The transaction involves the shareholders of a privately held company acquiring a shell company already listed on a public exchange through the purchase of a majority of the publicly traded shares.[21] In most cases, the shell company had previously liquidated its assets and had no real value other than outstanding securities.[22] The shell shareholders' share values become determined by the

14. *See* Erica Fung, *Regulatory Competition in International Capital Markets: Evidence From China in 2004-2005*, 3 N.Y.U. J. L. & BUS. 243, 250–52 (2006) (explaining that Chinese domestic markets are not very desirable because market forces cannot operate freely in China as the legal framework preserves an inefficient top-down management structure).

15. *See* 11A SIMON M. LORNE, ACQUISITIONS AND MERGERS § 3:11.10 (2011) (stating that companies can raise a lot of money in the United States partly because of the reliable and stable market system and also noting that many Chinese companies are specifically attracted to the NASDAQ because of its valuations of internet and technology companies).

16. *See* Leslie A. Gordon, *Red-Flagging China: Regulators Eye Chinese Companies Using Reverse Mergers to Enter US*, A.B.A. J., Oct. 2011, at 17.

17. *See* Luk, *supra* note 3.

18. *See* Dale A. Oesterle, *The High Cost of IPOs Depresses Venture Capital in the United States*, 1 ENTREPRENEURIAL BUS. L.J. 369, 370 (2007).

19. *See* Luk, *supra* note 3.

20. *See* LORNE, *supra* note 15, § 8:11.50; Gordon, *supra* note 16, at 18.

21. *See* LORNE, *supra* note 15.

22. *See* Aden R. Pavkov, *Ghouls and Godsends? A Critique of "Reverse Merger" Policy*, 3 BERKELEY BUS. L.J. 475, 478 (2006).

private entity's activities.[23] The merged private company, in effect, is therefore already registered with the SEC, bypassing the need for the private company to go public yet providing the company access to equity markets.[24] In essence, the private company becomes the SEC reporting entity with access to U.S. capital markets, and must file audited financial statements with the SEC as well as have an audit performed by a registered accounting firm.[25] This results in substantially all company operations residing in China with securities traded in the United States through the shell.[26] The merged companies are subject to audits and must provide financial statements, but there is increased consternation over the significant accounting deficiencies that raise concerns of whether some of these transactions are vessels for securities fraud.[27]

A reverse merger offers two advantages over an IPO: it can be completed both more quickly and less expensively, allowing firms with less capital to gain access to public markets.[28] Reverse mergers are not uncommon in corporate transactions in the United States, but the SEC and stock markets are suspicious of companies who choose to enter the U.S. public market through this route (rather than as an IPO) as there are fewer filing requirements and more room for fraudulent information to enter the capital markets.[29] Potential drawbacks in opting for a reverse merger over an IPO are the high costs of due diligence in selecting a shell company, problems getting free-trading stock, and dealing with other regulatory hurdles.[30] Nevertheless, the IPO process is still regarded as more time consuming and expensive, making the U.S. market less

23. *See id.*

24. *See* LORNE, *supra* note 15, § 3:11.10; *see also id.*

25. *See* CORNERSTONE RESEARCH, INVESTIGATIONS AND LITIGATION RELATED TO CHINESE REVERSE MERGER COMPANIES 2 (2011).

26. *See* LORNE, *supra* note 15, § 3:11.10 (explaining that securities fraud occurs when the operations of a U.S.–listed Chinese company are almost entirely in China, but the U.S. auditors are unable to catch the accounting deficiencies or fraud).

27. *See id.*

28. *See* Nahoum, *supra* note 2, at 1903–04 (establishing that the mean duration of a reverse merger is only ninety-two days compared to 287 days for an IPO, and the average assets of firms that do a reverse merger are only $2.19M as compared to $41.72M for firms that go through an IPO).

29. *See* LORNE, *supra* note 15, § 3:11.10.

30. *See* Nahoum, *supra* note 2, at 1904–05 (referencing the argument raised by critics of CRM transactions, claiming that the private company has to discover if the public shell shares are held by bona fide stockholders or if they are controlled by a stock promoter who is simply trying to sell the stock to increase the price, which can lead to artificially inflated share prices).

attractive than other world markets to Chinese companies:[31] According to the Public Company Accounting Oversight Board ("PCAOB"), from 2007 to 2010, only 56 Chinese companies entered the U.S. market through IPOs as opposed to 159 CRMs.[32]

Reverse mergers can be done with any foreign company, but Chinese and German companies predominately utilize the transaction within the United States.[33] German biotechnology firms come to the United States to access liquid markets with a well-established regulatory framework due to difficulties raising capital in Germany.[34] Chinese firms purport to have the same aim.[35] Unlike an IPO, there is only one requirement for firms seeking access to U.S. markets through a reverse merger.[36] In 2005, the SEC adopted new rules governing reverse mergers in an effort to protect investors from fraud.[37] These regulations require the surviving entity to file an amended, more detailed Form 8-K within four business days of the transaction.[38] This disclosure is a comprehensive summary of the corporation substantively similar to a Form 10 registration statement, which is required for the registration of securities under Section 12 of the Exchange Act.[39] This is an enhancement of the previous disclosure requirements on old Form 8-K that allowed for a seventy-one day window in which to file the Form.[40] The new four-day filing requirement

31. *See* Fung, *supra* note 14, at 245 (pointing out that Chinese issuers who do not want to deal with IPO and SEC burdens in the United States look to viable alternatives in Hong Kong and London); *see also* Paul Gillis, *Why Audit a U.S. listed Chinese Company?*, CHINA ACCT. BLOG (Aug. 31, 2011, 2:38 PM), http://www.chinaaccountingblog.com/weblog/why-audit-a-us-listed-chine.html (stating that the average fee for auditing a Chinese company was close to $3M for those listed on NYSE and $637,000 for those on the NASDAQ, meaning most smaller firms that come to the U.S. market do so through reverse mergers).

32. *See* Research Note, *supra* note 8, at 1.

33. *See* Nahoum, *supra* note 2, at 1907.

34. *See* Mennenoeh et al., *supra* note 3, at 131 (discussing the benefits for German firms to accessing U.S. markets through reverse mergers).

35. *See* CORNERSTONE RESEARCH, *supra* note 25, at 1.

36. *See* SEC Off. of Investor Educ. & Advoc., *supra* note 5, at 1.

37. *See* Use of Form S-8, Form 8-K, and Form 20-F by Shell Companies, 70 Fed. Reg. 42234 (Jul. 21, 2005) (to be codified at 17 C.F.R. pts. 230, 239, 240, 249).

38. *See* LORNE, *supra* note 15, § 8:1; *see also* 17 C.F.R. 249.380 (2011).

39. *See* LORNE, *supra* note 15, § 8:1.

40. *Compare* SEC, Form 10, http://www.sec.gov/about/forms/form10.pdf (last visited Oct. 17, 2011), *with* SEC, Form 8-K, http://www.sec.gov/about/forms/form8-k.pdf (last visited Oct. 17, 2011), *and* SEC, Form S-8, http://www.sec.gov/about/forms/forms-8.pdf (last visited Oct.

essentially requires that all merger consequences be contemplated in advance by the acquiring company.[41] The new regulations also require audited financial information as part of the Form 8-K disclosure.[42] Of the 159 CRMs that occurred in 2007 to 2010, 74% were audited by U.S. accounting firms and the remaining 24% by Chinese firms.[43]

Concerns raised by the SEC and shareholders have come from inquiries into the sufficiency of the audits performed by U.S. accounting firms of the Chinese companies. The PCAOB, a Congressionally-established non-profit auditing organization under SEC authority, undertakes to "oversee the audits of public companies in order to protect investors and the public interest by promoting informative, accurate, and independent audit reports."[44] The PCAOB reported that there has been an increase in CRMs[45] which have almost all of their operations in China, but use U.S. accounting firms to perform the required audits.[46] The PCAOB discovered that many of these accounting firms are not performing audits properly due to language barriers and a lack of understanding of domestic Chinese business practices, among other issues.[47] As a result, the auditors cannot provide an audit with a reasonable understanding of the company's financial statements.[48] In many ways, U.S. auditing firms are at a disadvantage in performing due diligence functions. They may lack the resources to obtain correct information from the company in China; the use of outside consulting firms to interpret the language and data without a reasonable basis for relying on

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17, 2011). Form 10 requires information on risk factors, financial information, and securities ownership of certain beneficial owners and management, among other things. Form S-8 cannot be used for a shell company unless the company has transformed from a shell and files a current Form 10. It is insufficient to simply provide the SEC with a complete Form S-8.

41. *See also* LUSONG ZHANG, REGULATION OF FOREIGN MERGERS AND ACQUISITIONS INVOLVING COMPANIES LISTED IN CHINA 173 (2007) (stating that the Chinese purchasing company is required to make full disclosure concerning its business affairs and financial condition to the seller as part of the merger process, as required by the Exchange Act).

42. *See* Research Note, *supra* note 8, at 6 (acknowledging that auditors must be registered with the PCAOB).

43. *See id.* The remaining two percent were Canadian auditing firms.

44. *See* PCAOB, http://pcaobus.org/About/Pages/default.aspx (last visited Oct. 17, 2011).

45. *See* Research Note, *supra* note 8, at 1.

46. *See id.*; *see also* CORNERSTONE RESEARCH, *supra* note 25.

47. *See* Research Note, *supra* note 8, at 8; CORNERSTONE RESEARCH, *supra* note 1, at 3.

48. *See* Research Note, *supra* note 8, at 8.

those consultants' opinions aggravate the perceived regulatory weaknesses of this transaction.[49]

As a result of these auditing difficulties, the SEC reacts with hostility towards CRMs because the transactions involving shell companies are susceptible to fraud.[50] The same propensity for fraud[51] has yet to be completely addressed even with increased regulation by U.S. authorities. As SEC Commissioner Luis Aguilar notes, some CRMs are "proving to have significant accounting deficiencies or being [used as] vessels for outright fraud."[52]

B. CLASS ACTION LAWSUITS AGAINST CRMS

Shareholders who have experienced a loss due to false disclosures and possible fraud have turned to the U.S. judicial system for recovery, but many of the defendant CRM companies deny the allegations against them.[53] Shareholders have brought thirty-three securities class action lawsuits alleging various violations, and seven of those CRMs have joined investment banks as co-defendants.[54] Between January 1, 2011 and June 30, 2011, CRMs and Chinese mergers and acquisitions litigation represented 47.9% of class action filing activity, up from 32.7% in the last six months of 2010.[55] The PCAOB has pointed to a lack of proper audits by U.S. auditing

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49. *See id.*

50. *See* LORNE, *supra* note 15, § 8:1 (noting that the SEC is weary of reverse mergers with shell companies because it is common for the post-reverse merger shell company to fail or become marginally public companies, and stock fraud is more common in reverse merger and shell companies than in other public companies; the SEC prefers to see companies enter the public market through IPOs because it tends to filter out companies that either won't succeed in the public market or firms that have faulty financial statements).

51. *See* Nahoum, *supra* note 2, at 1905 (referencing reverse merger fraud that took place in 1970–80s involving shell companies that had the sole purpose of raising money from public investors and removing the money from the corporation for their own benefit).

52. Sarah N. Lynch, UPDATE 1 — *SEC Probing Fraud at US-Listed Foreign Companies*, REUTERS (Apr. 4 2011, 3:15 PM), http://www.reuters.com/article/2011/04/04/sec-aguilar-idUSN0427084520110404; *accord* CORNERSTONE RESEARCH, *supra* note 25 (showing the concern that companies provided auditors with fraudulent information).

53. *See* David Feldman, *China: Boon for Litigators in 2011*, REVERSE MERGER BLOG (Aug. 26, 2011, 4:08 PM), http://www.reversemergerblog.com.

54. *See* CORNERSTONE RESEARCH, *supra* note 25, at 3.

55. *See* CORNERSTONE RESEARCH, *supra* note 1, at 1; *see also* CORNERSTONE RESEARCH, SECURITIES CLASS ACTION FILINGS — 2011 MID-YEAR ASSESSMENT, http://www.cornerstone.com/securities-filings-mid-year-2011/ (last visited Oct. 17, 2011).

firms performed for CRM companies as a possible cause of problems.[56] Subsequently, the SEC has started to target CRM company auditors.[57] This reaction could explain why the Bloomberg Chinese Reverse Merger Index has reported a 44% decrease in the value of CRMs in the first six months of 2011.[58]

C. Chinese Securities Regulation

The CSRC is a relatively new organization and serves a similar purpose as the SEC does in the United States. Securities regulation in China began in the early 1990s. An early attempt, the Regulations Regarding the Issuance and Trading of Stock, was enacted to develop China's socialist market economy.[59] The fledgling market, however, quickly proved to be susceptible to fraud through manipulation and falsified records.[60] In response, the State Council Securities Commission ("SCSC") was developed to regulate certain types of exchanges and was administered by the CSRC.[61] The SCSC and CSRC merged into the current CSRC, which drafts laws and regulations, develops policy, and monitors the securities market and related agencies.[62] Within the legal framework of Chinese securities laws provided through the CSRC, there are also "soft rules" that guide activity in securities transactions.[63] These "soft rules" are rules promulgated by the stock exchanges themselves, allowing for some form of self-regulation.[64] The Securities Association of China also contributes to the regulatory system by setting industry standards, training securities professionals, and mediating disputes between members and the CSRC.[65]

Shareholders are also empowered to enforce regulations. In 2002, the Supreme People's Court held that shareholders can

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56. *See* Research Note, *supra* note 8, at 7–8.

57. *See* CORNERSTONE RESEARCH, *supra* note 1, at 13.

58. *See* CORNERSTONE RESEARCH, *supra* note 1, at 13.

59. *See* 2 JAMES M. ZIMMERMAN, CHINA LAW DESKBOOK: A LEGAL GUIDE FOR FOREIGN-INVESTED ENTERPRISES 758 (3d ed. 2010).

60. *See id.* at 756.

61. *See id.* at 759.

62. *See id.*

63. *See* Shin-yi Peng, *The WTO Legalistic Approach and East Asia: From the Legal Culture Perspective*, 1 ASIAN-PAC. L. & POL'Y J. 13, 11, 19–21 (2000) (noting the general Chinese preference for ambiguous and informal dispute resolution mechanisms and regulations).

64. *See* ZIMMERMAN, *supra* note 59, at 757 (discussing regulations issued by the Shanghai and Shenzhen stock exchanges).

65. *E.g. id.* at 762.

sue a company in a lower court if they believe that the company has disclosed false information.[66] Shareholders are permitted to bring suit individually, or together, but they cannot bring a class action lawsuit.[67]

China acts in cooperation with other securities regulatory bodies on an international level. China is a member of the International Organization of Securities Commission ("IOSCO"), a non-profit institution that aids in the transfer of expertise between developing and developed countries.[68] While IOSCO has uniform regulatory rules, the rules are non-binding on members.[69] Nevertheless, China's membership in this international organization has helped increase the standardization of Chinese securities regulations through Memoranda of Understanding with foreign securities regulatory bodies.[70] China is also a member of the International Accounting Standards Committee ("IASC") which has helped develop a uniform standard of accounting endorsed by China's Ministry of Finance.[71] Cooperation with these bodies has helped shape the Chinese securities regulatory system and the practices of the CSRC, but the system is not without discrepancies that leave room for fraud.[72]

Within China, the CSRC supervises all public offerings. Only LLCs are approved by the CSRC to issue shares.[73] The application to go public requires reports from underwriters and auditors, all of whom may be held jointly and severally liable in the case of incomplete or false disclosures.[74] The underwriter is a securities firm that sells the shares to investors on behalf of the company, as Chinese companies in China cannot sell directly to investors.[75] A company's underwriter works to ensure proper disclosure compliance.[76] The underwriter must take corrective action if it finds false information contained in the company's prospectus and must also ensure that post-

66. *See id.* at 818–19.
67. *See id.* at 819.
68. *See* JANE FU, CORPORATE DISCLOSURE AND CORPORATE GOVERNANCE IN CHINA 206 (2010).
69. *See id.*
70. *See id.*
71. *See id.* at 207.
72. *See id.* at 209.
73. *See* ZIMMERMAN, *supra* note 59, at 773.
74. *See id.*
75. *See id.* at 776.
76. *See id.* at 773–74.

offering internal controls are effective.[77] The CSRC also supervises the issuance of Chinese company stock abroad.[78] Chinese companies must submit an application to the CSRC, which includes financial and operational information, in order to seek approval for foreign share issuance.[79]

Chinese securities laws are based on basic principles of investor protection, increasing transparency and fairness, and working within a highly regulated industry.[80] Unsurprisingly, fraud is a prohibited trading activity.[81] Entities involved in securities trading are forbidden from making "false or misleading statements or omissions concerning information that is material to the sale of stock" as well as from "forging, altering or destroying operational records or accounting books of the company in order to affect the issuance or trading of the company's stock."[82] Similarly, it is a criminal offense to manipulate share prices by providing false information.[83]

In order to enforce such principles, Chinese corporations must keep detailed financial and administrative records of the company.[84] Not surprisingly, corporations are not eager to meet these requirements and China has not yet cultivated an environment conducive to disclosure.[85] Chinese corporations must submit midterm and annual reports to the CSRC,[86] resembling the SEC requirements of Forms 10-Q and 10-K. At the end of a fiscal year, companies must provide a financial report that is to be audited by an auditing firm nominated by the shareholders or board.[87] Corporations must provide all necessary and requested information to the auditors, and is also expressly forbidden from providing false information.[88] If

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77. *See id.* at 774, 777.

78. *See Id.* at 793.

79. *See id.*

80. *See* 2 GAO LINGYUN & JIA XILING, SERIES ON CONTEMPORARY CHINESE LAW: CHINESE BUSINESS LAW 273 (Charles Wellford & Robert L. Jacobson eds., 2008).

81. *See id.* at 310.

82. *See* ZIMMERMAN, *supra* note 59, at 790–91.

83. *See id.* at 1041.

84. *See id.* at 766 (stating that corporations must keep minutes of meetings, financial and accounting records, and the articles of association must include a number of listed items).

85. *See* FU, *supra* note 68, at 210–11. Compliance is seen as a burden and many companies only provide minimal information. Companies also avoid disclosure if it will hurt their share price.

86. *See* ZIMMERMAN, *supra* note 59, at 784.

87. *See* LINGYUN & XILING, *supra* note 80, at 57–58.

88. *See id.* at 58.

the corporation experiences a material change or major event that could have a significant impact on the market value of its shares, it must file a report with the relevant stock exchange and the CSRC.[89] Further, there are additional strict procedures for mergers and other capital changes, as corporations are required to notify creditors and make a public announcement within thirty days of completing such a transaction.[90] Disclosure exemptions, however, can be granted by the stock exchanges if the disclosure will damage the company's interest.[91]

Yet even with the thorough regulatory framework, securities fraud in the form of false financial or operational information is still a problem.[92] Beginning in the mid-1990s a CRM firm, Sino-Forest, orchestrated a $4 billion dollar Ponzi scheme by fabricating information on its forestry operations.[93] Canadian and U.S. regulators and investors failed to realize Sino-Forest's operations claimed to be far in excess even of what Chinese logging regulations allowed.[94] By providing auditors with only 0.3% of company information (claiming the rest was competitive information)[95] and obscuring the company's structure with numerous subsidiaries, Sino-Forest defrauded investors for more than fifteen years. Due to both the company's manipulations and the difficulty of verifying its information and assets, auditors were unable or unwilling to identify the basis for securities fraud.[96]

In 2002 a CSRC-conducted survey showed that at least one in ten publicly listed companies doctored its books.[97] As a result, the securities laws were revised in 2005 for the protection of Chinese investors, allowing the government an increased ability to intervene, pushing for greater disclosure requirements, and increasing the penalties for securities

89. *See* ZIMMERMAN, *supra* note 59, at 785; *cf.* SEC, *supra* note 40.

90. *See* LINGYUN & XILING, *supra* note 80, at 54.

91. *See* ZIMMERMAN, *supra* note 59, at 785.

92. *E.g.* Fung, *supra* note 14, at 253; FU, *supra* note 68, at 211 (finding that the high capital requirements for an IPO in China force some companies to decide to provide false information on profits).

93. *See* Carson C. Block, *Muddy Waters Research*, (June 2, 2011) http://www.muddywatersresearch.com/wp-content/uploads/2011/06/MW_TRE_060211.pdf.

94. *See id.* at 14.

95. *See id.* at 2.

96. *See id.* at 1.

97. *See* Fung, *supra* note 14, at 253.

violations.[98] It remains doubtful whether these additional regulatory attempts will prove more resilient against such widespread tampering of financial statements.

A more comprehensive method of dealing with the inadequacies posed by Chinese domestic regulations would be to resort to common tools utilized in international law. While no standing bilateral or multilateral treaty addresses fraudulent reverse merger transactions, a treaty-based solution is the best way to halt the fraudulent CRM trend. In addition to tackling this specific type of transaction, a broad based securities and accounting treaty would be invaluable in shining greater light on international merger issues generally.

D. ADDRESSING CRMS THROUGH COMPETITION LAW

Competition law, also referred to as antitrust law, aims to enhance market competition by regulating anti-competitive behavior.[99] Competition laws, generally speaking, prohibit domestic anti-competitive conduct through substantive limits on business operations, procedural requirements of disclosure and auditing, or both. Developing as well as developed countries, however, are increasingly examining the scope of competition laws.[100] Competition law generally encompasses regulations on mergers, anti-monopoly laws, and concerted conduct laws.[101]

Merger control laws were first enacted in China to address anti-competitive abuses by foreign corporations and investors.[102] As the Chinese market moved away from a government-planned economy, regulators sought to moderate the transition by enacting measures designed to combat anti-competitive practices.[103] These new laws, modeled after laws in the United States and the European Union,[104] focused China's efforts generally on preventing harm to Chinese consumers and

98. *See* LINGYUN & XILING, *supra* note 80, at 271, 273.

99. *See* MARTYN TAYLOR, INTERNATIONAL COMPETITION LAW: A NEW DIMENSION FOR THE WTO? 1 (2006).

100. *See* MAHER M. DABBAH, INTERNATIONAL AND COMPARATIVE COMPETITION LAW 1 (Maher M. Dabbah & Barry Hawk eds., 2010). Cross-border influence of domestic competition laws is not necessarily bilateral, but extends beyond that as some countries are actually using the competition laws of another as the model rules in their jurisdictions. *See id.* at 5.

101. *See id.* at 32-36.

102. *See id.* at 99.

103. *See id.* at 97.

104. *See* NEE & TAO, *supra* note 9, at 324.

specifically in controlling mergers and acquisitions.[105] Unfortunately, the usefulness of these regulations remains doubtful due to the spotty enforcement record.[106] Because of China's emphasis on the merger transaction, the harm created by the CRM trend is beyond the scope of those regulations. While Chinese consumers may share in some of the harm of a fraudulent CRM, foreign investors also share exposure.

Whether there should be an international competition law is a hotly debated topic.[107] Almost all competition laws have the broad purpose of serving economic, social, and political needs.[108] Competition laws do this through the promotion of trade and enhanced economic liberalization through privatization, helping to develop a market economy.[109] Fraudulent financial reports by publicly traded companies have an anti-competitive effect on the market by negatively impacting consumer welfare.[110] A bilateral or multilateral treaty could succeed at bringing international competition law into cross-border transactions.

While international competition law does not fall under the purview of the WTO, there is a historical connection between trade laws and international competition laws.[111] Both aim to increase economic efficiency as well as global and national welfare.[112] The draft charter for the International Trade Organization ("ITO"), established following World War II, had an ambitious goal, requiring multilateral regulations and monitoring of international anti-competitive behavior, but this was widely opposed and disregarded along with the Havana

105. *See* SEUNG CHONG, THE LAW AND PRACTICE OF MERGERS AND ACQUISITIONS IN THE PEOPLE'S REPUBLIC OF CHINA 96 (2007).

106. *See id.* (noting that merger control hasn't been a significant factor in transactions in China).

107. *See* DABBAH, *supra* note 100, at 1–2, 30–31 (noting that the scope of competition law has been growing and that debates on the purpose of competition law are expected to increase in the global context, also noting that international competition law has "give rise to serious disagreements")

108. *See id.* at 39.

109. *See id.* at 41. These laws and goals are particularly important to economies in transition. *See id.* As China has only recently opened up, it is still new to the market economy and fits into this qualification. *See id.*

110. *See id.* Bork's opinion is that courts should aim to maximize consumer wealth and satisfaction, requiring courts to prioritize efficiency and decrease harmful practices. Reporting fraud would likely be considered one of those practices.

111. *See* TAYLOR, *supra* note 99, at 148. In 1927, the League of Nations' World Economic Forum recognized a need for coordinated regulatory attention at the international level to prevent anti-competitive conduct.

112. *See id.* at 167.

Charter as a whole.[113] The General Agreement on Tariffs and Trade ("GATT"), established in 1947, did not address the anti-competitive trade practices that had been considered in the Havana Charter.[114] However, member nations submitted initiatives to incorporate competition law into the GATT.[115] In 1993, the Uruguay Round concluded with the formation of the WTO, a modern version of the early ITO.[116] Yet, the Uruguay Round agreements still did not include an agreement on international competition law.[117] What the Round did accomplish however, was the creation of the Agreement on Trade-Related Investment Measures ("TRIMs") which contains a review provision that allows TRIMs to address competition law at the discretion of the Council for Trade in Goods.[118]

In 1996, the WTO's Ministerial Conference created a working group to look at anti-competitive behavior and determine whether an international competition law should be included in the WTO framework.[119] The Uruguay Round did establish a few provisions that address specific instances of anti-competitive conduct,[120] but none address the problems associated with fraudulent financial reporting or disclosure requirements. Lamentably, the WTO seems to address competition law strictly on an ad hoc basis.[121]

E. CHINA'S INVOLVEMENT IN INTERNATIONAL INVESTMENT

113. *See id.* at 150–51. Ratification of the Havana Charter officially failed in 1950. *See id.* at 153.

114. *See id.* at 153–54. The GATT aimed to increase aggregate welfare by reducing trade barriers and eliminating discrimination. While the Kennedy Round (1967) and Tokyo Round (1979) increased the scope of the GATT by adding non-tariff barriers to trade, it still did not address competition law. *See id.*

115. *See id.* at 155.

116. *See id.* at 158–59.

117. *See id.* at 159. Member nations recognized the complex relationship between trade law and competition law and concluded that more investigation needed to be done on the subject.

118. *See Uruguay Round Agreement: Agreement on Trade-Related Investment Measures*, WTO, http://www.wto.org/english/docs_e/legal_e/18-trims_e.htm (last visited Mar. 20, 2011) (referring to Art. 9, also known as the "review provision").

119. *See* Clifford A. Jones & Mitsuo Matsushita, *Preface* to COMPETITION POLICY IN THE GLOBAL TRADING SYSTEM v (Clifford A. Jones & Mitsuo Matsushita eds., 2002) (predicting that international competition would be an issue in the Doha Round).

120. *See* TAYLOR, *supra* note 99, at 159.

121. *See id.* at 163 (pointing to the fact that this highly localized approach is inconsistent with the overall unified methods and purpose of the WTO agreements).

TREATIES

China became a member of the WTO in 2001 by committing to a number of trade-liberalizing agreements. These agreements have one effect, among others, of increasing competition.[122] This increased competition has shaped China's law on both domestic and foreign investment.[123] China has shown a willingness to be a greater actor in international investment activities by becoming a party to both bilateral and multilateral treaties on the subject.[124] In the absence of a relevant multilateral agreement, China has created numerous bilateral agreements on investment promotion with countries around the world.[125] For example, China has a bilateral agreement with India that requires each government to encourage investments and protect the interest of investors in both countries.[126]

To summarize, while they may be potential vehicles for fraud, reverse mergers are likely to continue to exist, as they are an appealing alternative as compared with IPOs for private companies seeking to enter the public market. Unilateral action by the SEC, CSRC, and other relevant agencies has proved insufficient as a means of preventing fraud. Rampant accounting and disclosure fraud and a lack of enforcement of accounting standards within China present an international problem, requiring a solution through international law.

II. EVALUATING SOLUTIONS TO THE CRM PROBLEM

Regardless of whether courts find fraud to be present in the pending cases, the underlying cause of the shareholder class action lawsuits appears to be the auditing practices of CRMs. Auditors utilizing this faulty accounting information allow the continued recycling of baseless financial reports.[127] Unilateral action by the SEC or other U.S. agencies is insufficient to protect American shareholders, highlighting the

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122. *See* LIU XIAOHONG ET AL., SERIES ON CONTEMPORARY CHINESE LAW: CHINESE INTERNATIONAL ECONOMIC LAW 230 (Charles Wellford & Lauryn Beer eds., 2008).

123. *See id.* at 129.

124. *See id.* at 128.

125. *See id.*

126. *See id.*

127. *See* Gordon, *supra* note 16; Luk, *supra* note 3, at 15 ("Almost three in four Chinese reverse merger companies are audited by U.S. auditors, but as the Public Company Accounting Oversight Board highlighted in a March report, some of these firms do not seem to be doing their job properly.").

need for a solution employing international law.[128] However, many international law options, while good in theory, are not feasible in practice. Bilateral investment treaties are too narrow in scope, and a multilateral agreement on investment, while sufficiently broad in scope, is likely too politically charged to gain traction in international negotiations.[129] Using international competition law to mandate a standard for accounting and auditing between China and the United States is the optimal solution. With China increasingly focusing on antitrust concerns and reviewing cross-border transactions,[130] transitioning the audit process to China under U.S. accounting standards would, at a minimum, grant auditors greater access to a company prior to its entrance into U.S. securities markets. Coupling greater access with more stringent accounting standards will go a long way to combating the fraud potential posed by CRMs.

A. UNILATERAL U.S. REGULATION IS INSUFFICIENT TO ADDRESS THE CRM PROBLEM

Prior regulatory attempts to address CRM fraud merely changed the time frame given to the company to provide the SEC with audited financial information.[131] The 2005 Form 8-K disclosure requirement did not offer incentives to reverse mergers to provide more accurate or transparent information. Given the nature of the reverse merger the SEC is not in a position to provide IPO-type heightened scrutiny under the Securities Act,[132] leaving room for the transmission of fraudulent information. Short of converting the reverse merger transaction into an IPO, it seems that increased SEC regulations will not necessarily negate that transmission potential. In any event, the negligence occurs at earlier stages when inadequate audits are performed.

The risks and regulatory challenges posed by reverse merger transactions leaves open the question of whether or not this transaction should simply be eliminated. Such a proposition is not easily attempted, however, since the SEC

128. *See, e.g.,* Luk, *supra* note 3, at 15 (discussing the futility of auditing with respect to CRMs with recent examples).

129. *See* KENNETH J. VANDEVELDE, BILATERAL INVESTMENT TREATIES 1 (2010); CHEN HUIPING, OECD MULTILATERAL AGREEMENT ON INVESTMENT: A CHINESE PERSPECTIVE 8–12 (2002).

130. *See* REGIONALISM, MULTILATERALISM, AND ECONOMIC INTEGRATION 94 (Gary P. Sampson & Stephen Woolcock eds., 2003).

131. *See* Pavkov, *supra* note 22, at 484.

132. *See id.*

cannot prohibit them per se.[133] Even if it were possible for the SEC to do so, outlawing reverse mergers would be an over-inclusive solution to the fraud perpetuated by a select number of CRMs. Prohibiting all reverse mergers would deny investors access to investments in "embryonic companies with high growth potential" to those who are not venture capitalists.[134] As most small companies are high-risk and unable to attract venture capital, investment bankers or underwriters are unlikely to take on a costly and time consuming IPO process, making the IPO track an unattractive option to raise capital.[135] For this type of small, but high growth potential company, a reverse merger is a more cost effective method of reaching the equity markets. The solution is not to restrict market entry only to IPOs. A better solution is to gain control over the accounting and auditing process performed by or for foreign companies.

Both the company and the external auditor, as opposed to just the company, should face liability for fraudulent disclosures. Recently, the SEC has shown a willingness to prosecute CRM accounting firms, embracing this principle.[136] In 2010, the SEC investigated Moore Stephens Wurth Frazer & Torbet LLP, a PCAOB U.S.–registered accounting firm that performed audits for many CRMs.[137] The investigation revealed that the firm failed to perform the correct financial evaluations, choosing instead to rely on management's representations, even after discovering in 2004 that the client's internal controls could not reasonably be relied upon.[138] In many cases, however, there is no such history of facial misrepresentation by the

133. *See* Dena Aubin & Andrea Shalal-Esa, *INSIGHT — Where Was SEC As Trouble Festered At Chinese Companies?*, REUTERS, July 10, 2011, http://www.reuters.com/article/2011/07/10/china-accounting-enforcement-idUSN1E76905A20110710.

134. *See* Pavkov*,* supra note 22, at 489.

135. *See* Pavkov*,* supra note 22, at 489 ("Due to the economics of IPOs, early stage companies are not generally courted by underwriters and brought to market through the traditional process . . . . Smaller businesses simply do not make it over the IPO hurdle.").

136. *See, e.g.*, Andrea Shalal-Esa & Sarah N. Lynch, *Exclusive: Justice Department Probing Chinese Accounting*, REUTERS, Sept. 29, 2011, http://www.reuters.com/article/2011/09/29/us-china-usa-accounting-idUSTRE78S3QM20110929 (last visited Mar. 7, 2012) (discussing Department of Justice subpoenas of an arm of Deloitte Touche in Shanghai).

137. *See* Luk, *supra* note 3, at 18.

138. *See* Bob Scott, *SEC Suspends California Audit Partner*, THE PROGRESSIVE ACCT. (Dec. 20, 2010, 11:42 PM), http://www.theprogressiveaccountant.com/news/sec-suspends-california-audit-partner.html.

Chinese company.[139] Chinese companies may simply be taking advantage of the limitations faced by U.S. auditors, and depending on those limitations to obscure financial misrepresentations.[140] Auditors, feeling the heat of SEC warnings and investigations, have suggested as much. George Qin, the head of MaloneBailey, LLP's China audits, stated that "it is the companies who are committing fraud," not the auditors.[141] While it is clear in some cases that the SEC has a case against an auditing firm, such smoking gun evidence is the exception rather than the rule.

Shareholder lawsuits claiming violations of securities regulations are also an ineffective solution. The class action lawsuit brought against China North East Petroleum Holding Ltd. ("China North") in June 2010 was one of the first in the series of cases filed against CRM companies.[142] Shareholders brought suit after a series of announcements made by China North, during which time the share prices fluctuated.[143] Share prices were adversely affected when China North announced that its previous financial statements may have been incorrect.[144] A few months later, China North issued a Form 8-K that announced the company had misreported its net income by almost 100%.[145] The court granted China North's motion to dismiss, holding that the shareholders had opportunities to sell without suffering a loss, meaning the loss they did suffer could not be attributed to alleged misrepresentations.[146]

This case is relevant in considering the potential for the United States to develop a unilateral solution. The Form 8-K was not considered by the court, because the claim failed to

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139. *See* Luk, *supra* note 3, at 15.

140. As of March 2010 that firm had performed ten CRM audits, the most of any other firm. *See id.* at 17.

141. *See id.* at 15.

142. *See In re* China N. E. Petroleum Holdings Sec. Litig., 2011 WL 4801516 (S.D.N.Y. Oct. 6, 2011). *See also* Kevin LaCroix, *Securities Suit Against U.S.–Listed Chinese Company Dismissed*, THE D&O DIARY (Oct. 20, 2011, 10:15 AM), http://www.dandodiary.com/2011/10/articles/securities-litigation/securities-suit-against-uslisted-chinese-company-dismissed/.

143. *See* LaCroix, *supra* note 142.

144. *See* Complaint at 3, *In re* China N.E. Petroleum Holdings Sec. Litig., 2011 WL 4801516 (S.D.N.Y. Jan. 14, 2011) (No. 10-CV-04577-MGC).

145. *See id.* at 3–5 (stating that as earnings were actually $10.5M instead of $19.5M, corruption was found to be likely, so the NYSE AMEX suspended trading until September, but when trading resumed the share price fell 47% from $9.37 to $4.42).

146. *See* LaCroix, *supra* note 142.

survive early motions to dismiss.[147] Shareholders bear a considerable burden in claiming fraud as they must meet the heightened pleading standard required by Federal Rule of Civil Procedure 9(b) and Exchange Act Rule10b-5, which requires that the defendant knowingly or recklessly provided deceptive information in connection with the purchase of securities.[148] Therefore, even if the SEC were to develop an elaborate set of laws that could detect fraud before it damaged shareholders, it would not resolve the hurdle of heightened pleading requirements.

Even for shareholders that are able to obtain U.S. judgments, they face substantial difficulty in recovering from the Chinese company. The shareholders of Orient Paper, Inc. claimed that reported revenues were substantially overstated due to Orient Paper's false disclosures of operations in China.[149] The 2008 Form 10-K had been audited by a disbarred auditor and shareholders were suspicious of the CEO's ownership of seventy per cent of one of the suppliers.[150] In July 2011, the court found a strong inference of scienter in the alleged conduct, dismissing the defendant's motion for summary judgment.[151]

Despite this favorable judgment, "[t]he enforcement of foreign judgments in China has been notoriously difficult in recent years."[152] As these companies are based primarily in China, with substantially all of their operations occurring in China, the funds are not accessible by U.S. judgment without the approval of a Chinese court.[153] Though in theory the court may grant a judgment against the parent corporation as all of

147. *See In re* China N. E. Petroleum Holdings Sec. Litig., 2011 WL 4801516 (S.D.N.Y. Oct. 6, 2011).

148. Plaintiff-shareholders must support all allegations of securities fraud with the "who, what, when, where, and how" of the events. Claiming a violation under § 10(b) and Rule 10b-5 require at least an inference of scienter. *See In re* Heckmann Corp. Sec. Litig., 2011 WL 2413999, at *8 (D. Del. June 16, 2011).

149. *See* Amended Complaint at 3, Henning v. Orient Paper, Inc., 2011 WL 1160486 (C.D. Cal. July 20, 2011) (No. 2:10-CV-05887-VBF-AJW).

150. *See id.* at 5.

151. *See id.*

152. *See* Arthur Anyuan Yuan, *Enforcing and Collecting Money Judgments in China From a U.S. Judgment Creditor's Perspective*, 36 GEO. WASH. INT'L L. REV. 757, 758 (2004).

153. *See* Gillis, *supra* note 31 (stating that there is also no way to enforce the defendant corporation to appear in court which would result in a default judgment against them, again, with no way to be enforce the judgment); Yuan, *supra* note 152.

its board members and principal officers reside and work in China, Chinese courts are not likely to recognize the foreign judgment on the grounds that it is contrary to "state sovereignty, security and/or public policy."[154]

U.S. stock exchanges do possess some power to enforce compliance with securities regulations.[155] In the case of China North, for example, the NYSE AMEX determined that corruption was likely involved and suspended shares from trading.[156] However, this had the effect of damaging shareholders who had not yet sold their shares as the share price fell by forty-seven per cent[157] when trading finally resumed. While suspending trade could have a deterrence effect for companies considering filing false disclosures, it is rather a weak post hoc solution that fails to protect unsuspecting shareholders.

A unilateral solution devised by the United States will be insufficient to prevent future misleading information from entering the U.S. public market. As suggested by a senior partner with PKF, a major auditing firm involved in CRM audits, closer cooperation between the countries would help with the audit quality.[158] A cross-jurisdictional solution of cooperation between firms would enable U.S. firms to rely on the assistance provided by Chinese firms familiar with the area, language, and business environment, provided they have the quality of professional standards to be PCAOB certified. But this solution seems unlikely without a body that would oversee and enforce the Chinese audit process.

B. UNILATERAL CHINESE REGULATION IS UNLIKELY OR INSUFFICIENT TO ADDRESS THE CRM PROBLEM

No agency in China expressly regulates private companies merging with foreign public corporations.[159] The most efficient solution to the CRM trend is for the CSRC, which controls the issuance of Chinese company stock outside of China through the Overseas Share Regulations, to formulate new regulations

154. *See* Yuan, *supra* note 152, at 767.

155. *See* Luk, *supra* note 3, at 14.

156. *See* Complaint at 16, *In re* China N.E. Petroleum Holdings Sec. Litig., 2010 WL 2483602 (S.D.N.Y. June 11, 2010) (No. 10-CV-4577).

157. *See id.*

158. As of March 2010 that firm had performed ten CRM audits, the most of any other firm. *See* Luk, *supra* note 3, at 17.

159. *See* ZIMMERMAN, *supra* note 59, at 793–94 (showing that the CSRC is limited to regulations dealing only with the issuance of Chinese companies outside of China).

that directly regulate CRMs.[160] Unfortunately, this is not likely.

Currently, CRMs escape extensive review by both the SEC and the CSRC. Normally the CSRC would oversee an application process that reviews financial and operational information before a company would be allowed to issue stock abroad.[161] This type of review, however, only extends to "regulated transactions." Reverse mergers are not considered regulated transactions within China's new merger control regime — a regime which regulates the acquisition of domestic companies by foreign entities.[162] Regulated transactions undergo mandatory review, with an eye to antitrust violations. If reverse mergers were included within the regulated transaction umbrella, the CSRC review would function as a preliminary audit of the company's overall position. This could effectively prevent fraudulent information from reaching U.S. markets. In this way, information disclosed by U.S.–listed Chinese companies would have been audited in China in the first instance by auditors with experience in the Chinese business environment and proficiency in the language.

This domestic solution is not without challenges. First, there is a glaring lack of regulatory will. Policy makers in China actively promote foreign direct investment ("FDI") as opposed to foreign indirect investment ("FII"), represented by reverse mergers. [163] In fact, reverse mergers run counter to Chinese policies and China's regulation of foreign investment.[164] The failure by regulators to address this inconsistency either by prohibiting reverse mergers or including it as a regulated transaction is striking. It is likely that Chinese policy makers considered the conduct of private companies partaking in a foreign reverse merger and subsequently decided to forego any meaningful regulation.

Second, there is no way to ensure or require Chinese regulators to provide the quality of professional auditing or accounting standards required by the PCAOB. It is widely

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160. *See id.* at 793.

161. *See id.* The review also consists of an offering plan, prospectus, and accounting records.

162. *See* CHONG, *supra* note 105, at 99 (describing the new merger control regime as limited and developing in jurisprudence).

163. *See* NORAH GALLAGHER & WENHUA SHAN, CHINESE INVESTMENT TREATIES 8 (Loukas Mistelis ed., 2009).

164. *See* CHONG, *supra* note 105, at 86–90. Indirect investment does not directly contribute to development as it is merely money held within a corporation which can be retained, distributed, or otherwise disposed of without improving infrastructure.

acknowledged that the laxity of domestic Chinese accounting standards makes the purchase of Chinese stock risky.[165] To meet the high standard of U.S. IPO requirements, many Chinese companies simply submit fabricated information.[166] While the CSRC has attempted to develop a stronger disclosure regime in the hope of creating a less deceptive market, its attempts have remained largely unsuccessful.[167] Despite membership in IOSCO and IASC, China's accounting standards still lag behind most Western economies.[168]

Third, the threshold test for mandatory review under merger law is the existence of a major factor that may seriously affect market competition. Without a history of interpretation of the "major factor" threshold, it is unlikely that reverse merger review would occur. Fourth, without the Chinese company disclosing that it will be entering into a CRM, there is little reason to assume a relevant authority would be aware of the transaction in order to notify the Ministry of Commerce ("MOFCOM").[169]

A number of provisions of Chinese law could ensure review of CRM company reports on financial and operations information prior to review by U.S. auditors.[170] They appear to have been little used at this point. If Chinese auditors had carefully reviewed the information submitted by Sino-Forest Corporation as an introductory step to a CRM, it is very likely that Sino-Forest would never have entered a public market. Even so, it is unlikely that the United States will be able to rely on the integrity of the Chinese auditors until the "soft law" from IOSCO or China's membership in IASC starts to show marked implementation into China's systems. In the

165. *See* Tan Wentao, *China's Stock Market*, *in* CHINA'S FINANCIAL MARKETS 209 (Salih N. Neftci & Michelle Yuan Ménager-Xu eds., 2007) (claiming the accounting system inadequately protects investors).

166. *See* FU, *supra* note 68, at 209 (finding that many companies forge profit information in order to obtain IPO approval).

167. *See id.* at 201. Chinese shareholders have a culture of relying on sources outside company disclosures to determine share health. Shareholders tend to not rely on disclosures because they are frequently false. *See id.* (describing that many investors based knowledge from friends and relatives). Further, without the rule of law enforcement is more difficult and many corporate officers simply continue to provide false information to meet disclosure requirements. *See id.* at 209.

168. *See id.* at 205 (discussing the lax standards of Chinese investment regulation).

169. *See id.* (stating that the threshold test for mandatory review was meant to be a low standard so as to catch as much as possible).

170. *See generally id.* at 201–02 (discussing the Securities Law of 1998 and CRSC crackdown as examples of China's actions on securities regulation).

meantime, it is worth considering hard law options between the two countries, to be discussed *infra*.

C. INTERNATIONAL INVESTMENT LAW IS INSUFFICIENT TO ADDRESS THE CRM PROBLEM

International organizations have prompted the WTO to consider an international investment law, as many countries have developed their own laws on cross-border investment.[171] As discussed, *supra*, bilateral investment treaties ("BITs") are common tools for this area, but lack the scope to adequately address the problem. Generally BITs only apply to FDI.[172] Seeing as this is not the type of investment involved in a reverse merger, a BIT would largely be unhelpful. A multilateral agreement on investment ("MAI"), however, is broad enough to encompass the accounting and disclosure issues of a reverse merger.[173] While an MAI is the most suitable treaty-based solution, in practice investment policy is very politically sensitive and thus an MAI is not likely to be adopted by the WTO.[174]

1. BITs Cannot Address Reverse Merger Indirect Investment Issues

The purpose of a BIT is to attract FDI between the contracting countries.[175] China, currently focused on encouraging FDI in certain industries, not FII,[176] has identified three main goals of a BIT: (1) facilitate and attract investment; (2) contribute to the prosperity of both contracting states; and (3) cooperate on the basis of equality and mutual benefit.[177]

BITs may appear to have a purpose broad enough to target the accounting and auditing problems arising from private Chinese companies, but so far none have emerged. A BIT proposed by the United States to China to protect international investors from fraud perpetuated by Chinese companies through inadequate disclosure enforcement and accounting

171. *See generally* Peter Holmes, *Trade & Competition Policy: At the WTO Issues for Developing Countries* (Ctr. on Regulation and Competition, 2003) (discussing barriers to a WTO competition law and the issues any such law should consider).

172. *See* GALLAGHER & SHAN, *supra* note 163, at 49.

173. *See* HUIPING, *supra* note 129, at 7.

174. *See id.* at 8–12 (chronicling the history of attempts to negotiate an MAI).

175. *See* GALLAGHER & SHAN, *supra* note 163.

176. Reverse mergers are a type of FII.

177. *See* GALLAGHER & SHAN, *supra* note 163.

standards is not likely to enter serious negotiations.[178] If a treaty were to be agreed upon, the additional problem of enforcement remains.

BITs are interpreted narrowly and are not currently used in China to target indirect investment.[179] Typically, the investing party is able to impose obligations on China through this process in exchange for investments to help the development of the Chinese economy and infrastructure.[180] While the purpose of a BIT is usually to reassure the investor that its investments are being used accordingly,[181] this does not mean that a BIT between China and the United States could not cover indirect investment. But problems would arise in the interpretation of indirect investment as there is almost no mention of it in other BITs, making the definition ethereal.[182] If a breach of the agreement did occur, which is likely given the distinct political goals of China and the United States, arbitration is not likely to provide a satisfying solution.[183]

With 126 BITs, China has one of the most extensive treaty networks to protect international investments.[184] Surprisingly, it has not entered into an agreement with the United States.[185] China and the United States entered BIT negotiations in 1983, but each country had very different issues it wanted to address; thus frustrating and eventually ending the negotiations.[186] If the United States were to propose an agreement containing sufficient regulations on accounting and disclosure issues, China would be unlikely to negotiate seriously.[187] While such reform would be vital to China's growth in FII and the development of the Shenzhen and Shanghai stock markets,[188]

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178. *See* HUIPING, *supra* note 129, at 6–7.

179. *See* VANDEVELDE, *supra* note 129, at 1–2.

180. *See id.* at 108.

181. *See id.* at 1–2.

182. *See id.* at 139.

183. *See generally* Duncan Hollis, *What Will A U.S.-China BIT Do To Investor-State Arbitrations*, OPINIO JURIS (Mar. 22, 2010), http://opiniojuris.org/2010/03/22/what-will-a-us-china-bit-do-to-investor-state-arbitrations/ (last visited Mar. 7, 2012) (discussing the challenges posed in developing a BIT that will soothe both countries' regulatory fears).

184. *See* VANDEVELDE, *supra* note 129, at 31.

185. *See id.* at 32.

186. Disagreement over the national treatment standard of the treaty was the primary stumbling block. *See id*. at 33.

187. *See id.* (arguing that the "highly prescriptive formula" embraced by the United States will make it difficult to negotiate a BIT).

188. *See id.* at 8 (claiming that China modified many laws in order to attract more FDI and national investors).

China prefers to focus on attracting FDI. Additionally, it seems unlikely that the United States would be able to assert sufficient pressure on MOFCOM to motivate it to propose a treaty to the State Council[189] that would require Chinese audits and corporate disclosures to meet the standard required in the United States.

2. An MAI Is Not A Practical Solution

While an MAI could properly address the issues raised by indirect investment and minimum accounting standard requirements, the recent history of failed attempts suggests that the WTO is not currently able to address this issue.[190] In 1995, the Organisation for Economic Co-operation and Development ("OECD"), of which China is not a member, initiated negotiations to form an MAI.[191] A report by the OECD on the purpose of MAIs states that:

> A multilateral agreement on investment would provide a strong and comprehensive framework for international investment and would strengthen the multilateral trading regime. It would set clear, consistent and transparent rules on liberalization and investor protection . . . .[192]

When negotiations in the OECD stagnated and failed, the OECD proposed that the WTO be the body to form such an agreement.[193] The WTO did not foreclose forming a treaty on international investments and a working group was created to look at the relationship between trade and investment.[194] While developed countries were not able to get an investment treaty on the Doha Round agenda, there remains a possibility that there will be a WTO treaty on the issue in the future, despite

189. *See id.* at 33–34 (discussing the process in which the MOFCOM applies to the State Council for negotiation of a treaty).

190. *See generally* HUIPING, *supra* note 129, at 1 (discussing the multiple attempts of the WTO to create an MAI).

191. *See id.* For a list of OECD member countries see *List of OECD Member Countries–Ratification of Convention on the OECD*, OECD, http://www.oecd.org/document/58/0,3343,en_2649_201185_1889402_1_1_1_1,00.html (last visited Feb. 13, 2012).

192. OECD, Rep. by the Comm. on Int'l Inv. and Multinational Enters. (CIME) and the Comm. on Capital Movements and Invisible Transactions (CMIT), A Multilateral Agreement on Investment, DAFFE/CMIT/CIME (95)13/Final, 5 May 1995, 1.

193. *See* HUIPING, *supra* note 129, at 1.

194. *See id.* The WTO formed a Working Group in 1996 following the Ministerial Conference in Singapore to create rules for multilateral investment treaties.

unsuccessful past attempts.[195] However, the likelihood and nearness of such a development is dubious.[196] A more immediate solution is needed to prevent fraud in the U.S. market from private Chinese companies.

The WTO had previously enacted TRIMs, which is covered by the Dispute Settlement Understanding ("DSU").[197] The DSU provides a mandatory forum for dispute resolution among member countries, such as China and the United States.[198] However, TRIMs does not specifically cover issues raised by reverse mergers.[199] TRIMs, introduced at the Uruguay Round, deals with the concept of regulating foreign investment as part of international trade.[200] While TRIMs deals with investment, it is not directly applicable to ensuring Chinese audits and disclosures meet U.S. standards for indirect investment.[201] TRIMs requires compliance with GATT, particularly the principle of national treatment under Article III:4 on internal regulations.[202] This principle requires that China not impose domestic regulations that treat other countries less favorably.[203] There is no evidence that China treats U.S. investments different from others, nor is there evidence that accountants, auditors, or corporate directors provide different information to U.S.–listed Chinese companies than they do to Chinese companies in other countries. It therefore appears that the TRIMs agreement is not applicable as a mechanism for enhancing China's accounting and disclosure standards.

An MAI would establish an investment code to protect the interests of all parties in an investment transaction. However, as was the case with a BIT, the primary purpose of an MAI is

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195. *See id.; see also* SURYA P. SUBEDI, INTERNATIONAL INVESTMENT LAW 52 (2008) (finding that while this topic was on the WTO agenda for discussion, it was abandoned it in 2004).

196. *See* HUIPING, *supra* note 129, at 1 (discussing that there remains only some chance that formal negotiations will be held on investment rules in the WTO).

197. *See* WTO, *Legal Texts: The WTO Agreements*, http://www.wto.org/english/docs_e/legal_e/ursum_e.htm#Understanding (last visited Feb. 13, 2012) (describing the DSU and TRIMS).

198. *See id.*

199. *See* SUBEDI, *supra* note 195, at 37 (showing TRIMS does not mention reverse mergers in the article text dealing with foreign investment).

200. *See id*.

201. *See id.* (arguing that TRIMS was applicable only to international instruments such as the GATT).

202. *See id.*

203. *See id.*

the regulation of FDI.[204] As China is one of the world's largest FDI recipients, such an agreement would have a direct effect upon investment to and from China.[205] MAIs, though, could also encompass broad issues as well, including indirect investment, making this a more relevant solution than a BIT; as described by the OECD, the goal of an MAI is to "set high standards for the treatment and protection of investment."[206]

Critics have complained that this type of agreement is a Bill of Rights for foreign investors.[207] However, if the purpose is to promote growth and development it is more than reasonable to accord investors, whose money makes possible that growth and development, certain internationally agreed-upon rights. The protection of investment and aim to liberalize trade seem to go hand-in-hand with a need to create a solid foundation in accounting, auditing, corporate disclosure, and enforcement regimes. While reverse mergers are primarily a problem between China and the United States, other forms of investment could benefit from being able to rely on information provided to Chinese stock markets. Meeting U.S. standards would help ensure that more accurate information reaches investors and that the stock market reflects the actual performance of the listed companies.

An MAI negotiated and agreed upon as a multilateral agreement within the WTO could subsequently be added to the covered agreements within the WTO DSU. This would provide all parties with a mandatory venue for dispute settlement and interpretation of terms within the agreement. The DSU does not follow a stare decisis tradition, but instead has accumulated legislation.[208] This legislation provides parties with guidance on how to draft and interpret agreements in an attempt to avoid future arbitration. The presence of a dispute settlement body could have the effect of increasing compliance with the MAI. While a non-WTO based MAI is possible, it is not preferable to the standardized enforcement and dispute resolution tools of the WTO.

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204. *See* SUBEDI, *supra* note 195, at 40.

205. *See* GALLAGHER & SHAN, *supra* note 163, at 2 n.2 (finding that China attracted a record $53 billion in FDI).

206. *See* SUBEDI, *supra* note 195, at 40 (citing OECD Rep. by the Comm. on Int'l Inv. and Multinational Enters. (CIME) and the Comm. on Capital Movements and Invisible Transactions (CMIT), A Multilateral Agreement on Investment, DAFFE/CMIT/CIME (95)13/Final, 5 May 1995, 1).

207. Critics claimed the MAI gave no thought to the social obligations of investors. *See id.* at 41.

208. *See* WTO, *supra* note 197, (describing how the DSU settles claims).

While an MAI might offer a potential solution to the problems posed by CRMs, the political appetite for such measures is lacking among WTO members. The Doha Round abandoned negotiations on foreign investment as it found the topic to be too complex for the WTO to accommodate.[209] With the wide variety of interests of member countries they were not able to even come to an agreement on the meaning of the term "foreign direct investment."[210] Some members are so disillusioned by the prior failed negotiations on the matter that many are reluctant to consider anything similar.[211] It therefore appears that an MAI through the WTO is not a realistic mechanism for enhancing China's standards of accounting or corporate disclosures.

III. THE CRM PROBLEM IS BEST ADDRESSED THROUGH A PLURILATERAL AGREEMENT

China is not likely to unilaterally increase enforcement of auditing and accounting standards without hard law pressuring or incentivizing enforcement. China's recent enactment of antitrust laws provides a basis for using competition law to review cross-border transactions, such as reverse mergers.[212]

Instead of a BIT, an MAI, or a TRIMs solution, discussed *supra*, the United States should pursue a plurilateral agreement through the WTO. This agreement would focus on macro issues of international competition law. In the background of a macro competition law, China and the United States could then engage in a bilateral agreement on the micro issues, including auditing and accounting standards. Through this approach, the risks of reverse mergers would be addressed.

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209. *See* SUBEDI, *supra* note 195, at 154; *see also* Magnus Feldmann, *The Association Agreement between the European Union and Poland*, *in* REGIONALISM, MULTILATERALISM, AND ECONOMIC INTEGRATION, *supra* note 130, at 51–52 (describing the process of establishing multilateral rules on foreign investment as "complex and tortuous").

210. *See* SUBEDI, *supra* note 195, at 154 (finding that WTO member states could not agree what an international treaty on FDI would cover).

211. *See* Joakim Reiter, *The EU–Mexico Free Trade Agreement: Assessing the EU Approach to Regulatory Issues*, *in* REGIONALISM, MULTILATERALISM, AND ECONOMIC INTEGRATION, *supra* note 130, at 94.

212. *See* HERBERT SMITH, *Chinese Antitrust Law Enacted at Last*, (Aug. 30, 2007), http://www.herbertsmith.com/NR/rdonlyres/6E845328-5888-4D0B-8DEF-FFA0C7C1EE56/4545/ChineseAntitrustLawenactedatlast.htm (last visited Feb. 13, 2012) (calling the newly enacted legislation "comprehensive in scope").

A. CHINA'S ANTI-MONOPOLY LAWS PROVIDE FRAMEWORK FOR IMPROVING ACCOUNTING STANDARDS

In 2008, China introduced antitrust laws after fourteen years of legislative drafting.[213] The Anti-Monopoly Law ("AML") encompasses a prohibition on monopolistic agreements, exploitive behavior, and government restraint of competition.[214] Crucially, the AML provides for merger review.[215] The existence of the AML is meant to encourage practitioners to consider the implications of merger or reverse merger transactions.[216] Such a review, focused on assessing the "effect of elimination or restricting competition,"[217] would require consideration of a company's market power. In order to adequately consider a company's market power, it stands to reason that regulators must be privy to correct and complete financial and operational information. The AML requires companies considering a merger to file audited financial and accounting reports from the past year.[218] Once filed, MOFCOM can take up to thirty days to review and submit a notification of approval or require further investigation, delaying the transaction by up to ninety days.[219]

This domestic backdrop is well suited to the applicability of an international competition law. AML is based on many of the same principles enshrined in competition law generally. Inculcating strong accounting standards for domestic mergers is likely to have a spillover effect on cross-border transactions, of which mergers are a part, necessarily implicating competition law.[220]

B. A PLURILATERAL AGREEMENT IS THE BEST FRAMEWORK FOR

213. *See* NEE & TAO, *supra* note 9, at 324. The competition laws are modeled after EU and U.S. competition laws.

214. *See id.* at 325.

215. *See id.*

216. *See id.* (demonstrating that the AML requires practitioners to consider possible sanctions, market restrictions, and prior approval rules when merging).

217. *See id.* at 339 (citing The Anti-Monopoly Law of the People's Republic of China, Art. 28 (adopted at the 29th meeting of the Standing Committee of the Tenth National People's Congress of the People's Republic of China, Aug. 30, 2007, effective Aug. 1, 2008), *translation available at* http://www.china.org.cn/government/laws/2009-02/10/content_17254169.htm)).

218. Additionally, companies must file a notification of merger, a statement explaining the impact of the merger on competition, and the concentration agreement. *See id.* at 337.

219. *See id.* at 338.

220. *See* TAYLOR, *supra* note 99, at 36 (discussing the rise of cross-border mergers as a part competition law).

ESTABLISHING AN INTERNATIONAL COMPETITION LAW

The United States, China, and other WTO members have the ability to draft and enforce a comprehensive competition law within WTO forums. This is an imperfect, yet novel, approach to solving the accounting and disclosure issues highlighted by the current CRM litigation. Competition law is capable of filling the gap presented by the U.S. and Chinese securities laws and enforcement issues. Investment regulations can be seen as an integral part of competition law. The differences in financial standards between the United States and China leave international investors vulnerable with almost no protections. While investment regulation in China is a very politically sensitive area and a proposed agreement between China and the United States is not likely to be well received, competition law provides a usable platform for further regulations. China has recognized that there is benefit to be derived from competition law[221] and the WTO presents the most logical enforcement body.

The WTO would provide an ideal system for dispute resolution, helping to drive compliance and enforcement of the treaty. With enforcement as one of the current problems, adoption of such a voluntary plurilateral agreement by the WTO would provide injured parties of member countries with procedures to obtain compensation for damage caused by fraudulent information.

The plurilateral status of the agreement would ensure that countries could enter the treaty voluntarily. China and the United States may be able to find common ground in competition law. The agreement could be drafted to require enforcement of related micro issues between signing parties in a bilateral agreement to be enforceable within the plurilateral agreement.

While Chinese and American competition laws appear to be converging,[222] the recent surge of litigation surrounding CRMs suggests that something more needs to be done in the interim to ensure proper financial disclosures are made and that auditing standards are followed. Plurilateral and bilateral agreements on international competition laws could address issues in both China and the United States in furtherance of

221. *See id.* at 91–92 (discussing competition laws China has enacted to prohibit firms of a specific market threshold from engaging in certain conduct).

222. *See id.* at 90–91 (showing that U.S. and Chinese competition laws are both being developed around the same behavioral thresholds).

each country's own political and economic agendas.

Rather than focusing directly on FDI and FII in MAIs, promoting regulation that would affect CRMs through international competition law stands a better chance of approval by WTO members. The plurilateral agreement would generally mirror the current AML within China and the bilateral agreement would focus solely on the accounting review required of internationally merging companies. This agreement, therefore, would be minimally intrusive into China's regulatory authority. There is already economic and political support for the creation of international competition law, as such a law "would be welfare enhancing relative to a situation in which each nation enforces its competition laws on an extraterritorial basis in accordance with its national self-interest."[223] WTO members are likely to reach an agreement on the macro issues of competition policy, leaving the micro issues to be resolved by individual countries.

Different countries' competition laws tend to be similar in substance and procedure.[224] Within Asia, however, not all members of a regional trade association, namely the Asia Pacific Economic Co-operation ("APEC"), have competition laws,[225] and those that do seem to function in a distinct manner.[226] This regional issue represents an even larger issue. If all WTO members are expected to agree on an international competition law, which requires a consensus, the law will inevitably be general in nature. It will not necessarily address Chinese accounting and corporate disclosure issues, but it may indirectly require that the existing structure and agencies in China start complying with defined competition obligations.

The issues of accounting and corporate disclosure standards are likely to be categorized as micro issues in the drafting of an international competition law.[227] Each country is likely to have very different ideas of what the micro issues are and countries will have divergent interests in micro issues based on their market conditions. It would be impractical, and inappropriate, for an international competition policy to

223. *See id.* at 69.

224. *See id.* at 75 (describing the rise of competition of laws as based on common notions such as fairness and well-accepted economic principles).

225. *See id.* (noting only some nations have adopted competition laws).

226. *See* TAYLOR, *supra* note 99, at 76 (arguing that competition laws are tailored to each country's culture and thus remain "nationally distinctive").

227. *See id.* at 79 (defining micro issues as those that regulate institutional influences and market definitions).

prescribe certain regulations within each country with the aim of unifying competition laws.

WTO members have the option of creating a broad competition law that would outline specific macro issues. Most countries believe that competition law should have the primary objective of encouraging competition, in the hope of increasing economic efficiency.[228] There is evidence that countries are likely to be able to come to a consensus on the key macro issues: merger laws, anti-monopoly laws, and concerted conduct laws.[229] Afterwards, a bilateral agreement between the United States and China should be developed, building on China's new competition laws and WTO-created international competition laws, which enforces U.S. accounting requirements and Chinese merger review. Such an agreement would cover the micro issues discussed *supra*.

The United States, along with other countries, embraces the extraterritoriality of competition law.[230] Specifically the United States recognizes the "effects doctrine" in competition law which allows U.S. antitrust laws to extend beyond U.S. jurisdiction if the transaction has a "material effect" on U.S. commerce.[231] This doctrine, and its counterpart laws of other countries, may indicate a growing trend towards recognizing the international effects of transactions occurring beyond a country's control and the growing need for an international competition law. As discussed above, though, it is necessary to make sure that such jurisdiction is enforceable, and this would only be possible with a bilateral agreement.

Any bilateral agreement between the United States and China regarding competition law must have proper enforcement mechanisms. The agreement should demonstrate a preference for case initiation by domestic agencies. For an agency to be an enforcer it must have access to detailed information about the companies.[232] U.S. enforcement agencies, such as the Federal Trade Commission and the Department of Justice,[233] could be granted access to the internal records of

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228. *See id.* at 77. This goal was identified by the World Bank and OECD.

229. *See id.* at 78–79 (finding these principles to be a key structure in all APEC competition laws).

230. *See id.* at 64–65. The laws are relatively new and limited.

231. *See* Edward M. Graham, *Approaches to Competition Theory*, *in* TRADE RULES IN THE MAKING 438 (Miguel Rodriquez Mendoza, Patrick Low & Barbara Kotschwar eds., 1999).

232. These enforcement duties grant such agencies broad discovery powers. *See id.* at 436.

233. *See* U.S. Dep't of Justice & FTC, *Horizontal Merger Guidelines* 1

firms and could apply penalties to firms who do not keep proper records. Currently in horizontal mergers, the Federal Trade Commission or Department of Justice reviews the market share of the merging companies to ensure they do not create an overly concentrated market.[234] While the only challenged mergers are those that pose a threat of concentration, it is the initial review of market share that requires preparation of records and reports relevant to reverse merger review.

China has similar agencies in place with similar powers.[235] A bilateral agreement could require that these Chinese agencies perform a thorough review of all companies engaging in a merger, which is currently required by law within China, as well as a review of all CRMs. Upon review of a CRM, the Chinese agency could send a report to the SEC on its overall impression of the firm given its financial and operational information. The SEC could then align the certification with the Form 8-K that CRMs must file after completing the transaction. A firm that failed to disclose its intention to merge to the relevant Chinese authority would not have a certification on file with the SEC, prompting the SEC to inform the Chinese agency which could then either require compliance or apply a penalty against the firm. In the meantime, the SEC and the exchanges could prevent the CRM from being listed.

IV. CONCLUSION

Within the United States, CRMs pose an unreasonable risk to investors who rely on information disclosed to regulators when deciding where to put their money. Chinese companies have exploited lax auditors and minimal regulatory oversight to gain access to U.S. markets using fraudulent financial data. The SEC has attempted measures at increasing disclosure requirements to combat this risk, but has failed to address the underlying problem of a lack of compliance with auditing, accounting, and disclosure requirements of companies within China. In China, CRMs represent a form of investment that is discouraged in favor of FDI, meaning there is no vested government interest in ensuring CRMs remain a convenient form of investment.

The optimal solution is not an outright ban on the reverse

(2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf.

234. *See id.* at 4–5 (describing the process in which market share is calculated to determine if a merger is appropriate).

235. *See* CHONG, *supra* note 105, at 99 (describing China's new merger control regime, but which only applies to foreign mergers).

merger transaction, as it does provide legitimate benefits to certain companies, but rather the formation of a plurilateral international competition law within the WTO. To more specifically address the CRM problem, this agreement should be immediately followed by a bilateral agreement between the United States and China. The international competition law could provide an international framework for the review of international merger transactions, while the bilateral agreement could address the specific procedures for ensuring Chinese companies are audited properly within China prior to entering U.S. markets.