

# Analysis of Securities Market Manipulation

## --Taking Kangmei Pharmaceutical as an example

Nini Wang

School of Law, Anhui University of Finance & Economics, Bengbu Anhui 233030, China

### Abstract

Securities market manipulation, a persistent problem in the capital market, seriously affects market price formation mechanisms, infringes upon the legitimate rights and interests of investors, and disrupts capital market order. The Kangmei Pharmaceutical case is a landmark case in the history of China's capital market, characterized by its covert manipulation methods, massive sums of money involved, and complete accountability chain. The controversies arising during its trial, particularly regarding the identification of securities market manipulation, the definition of the disclosure date, and the determination of causation, vividly reflect the difficulties and shortcomings of China's current legal system in dealing with complex manipulation. This paper uses the Kangmei Pharmaceutical securities market manipulation case as a research sample, combining relevant provisions of China's Securities Law and judicial practice to deeply explore the standards for identifying securities market manipulation, the rules for determining the disclosure date, and the logic for determining the causal relationship between manipulation and investor losses. Targeted suggestions for improvement are proposed, aiming to provide a reference for judicial organs in handling similar cases and safeguarding market fairness and justice and the legitimate rights and interests of investors.

### Keywords

Securities market manipulation, Kangmei Pharmaceutical, Disclosure date, Causation, Applicable law.

### 1. Introduction

The capital market is a core component of the modern market economy, and its healthy and orderly development depends on a fair, just, and open market environment. [1] Securities market manipulation, a typical form of securities violation, disrupts the market's spontaneous price formation mechanism by artificially intervening in securities prices and misleading market investors. This not only causes significant financial losses to investors but also undermines the stability of the capital market. Although the investigation and adjudication of securities market manipulation cases are continuously progressing, the increasing complexity and diversification of the capital market and the emergence of new manipulation methods pose new challenges to the identification and legal application of securities market manipulation. The Kangmei Pharmaceutical Co., Ltd. (hereinafter referred to as "Kangmei Pharmaceutical") securities market manipulation case, as the first large-scale investor class-action lawsuit in the history of China's capital market caused by market manipulation, involved hundreds of billions of yuan and over 50,000 investors. The case clarified many key legal application issues during its adjudication, marking a milestone in the regulation of securities market manipulation in China. This article takes the Kangmei Pharmaceutical case as a starting point, focusing on three core issues: the boundaries of securities market manipulation identification, the determination of the disclosure date, and the judgment of causation.

## 2. Overview of Basic Case Information

Kangmei Pharmaceutical Co., Ltd. (hereinafter referred to as "Kangmei Pharmaceutical") is a listed company with the production and sales of traditional Chinese medicine as its core business. It was listed on the main board of the Shanghai Stock Exchange in March 2001, with the stock code 600518. It was once recognized as a leading enterprise in the traditional Chinese medicine industry, with a peak market capitalization exceeding 100 billion yuan. [2] Its actual controllers are Ma Xingtian and Xu Dongjin, a married couple who control the company's core decisions through direct and indirect shareholding. Starting in 2018, the company was embroiled in a public relations crisis due to suspected serious securities violations. It was ultimately found to have engaged in securities market manipulation centered on its actual controllers and involving multiple entities, becoming a landmark case in the history of China's capital market characterized by its covert manipulation methods, huge sums of money involved, and complete accountability chain.

## 3. Key Issues in the Case

The core controversy in the Kangmei Pharmaceutical case centers on the determination of securities market manipulation and its disclosure date, as well as how to determine whether there is a causal relationship between the manipulation and investors' losses .

### 3.1. Disputes over the boundaries of identifying securities market manipulation

of the dispute lies in whether the actions centered on "financial fraud + related-party transactions" meet the statutory conditions for "manipulating the securities market" under the Securities Law (before the 2019 revision). Kangmei Pharmaceutical and some of its executives argued that the financial fraud constituted a violation of information disclosure, the related-party account transactions were "normal investment behavior," and the stock price fluctuations were a spontaneous market reaction, lacking any subjective intent to "manipulate," and therefore should not be considered as manipulating the securities market.

### 3.2. Disputes over the determination of the "disclosure date" for securities market manipulation

The crux of the dispute lies in the determination of the "disclosure date," which directly relates to defining the scope of the manipulation and thus determining which investors' losses can be attributed to it. This is the core procedural dispute in this case. Kangmei Pharmaceutical and some of its executives argued that October 16, 2018, should be the disclosure date, arguing that the stock price plummeted to its daily limit after the publication of the self-media article questioning the manipulation on that day, indicating that the market was aware of the manipulation clues, and that subsequent investor losses were unrelated to the manipulation. However, investors and regulatory authorities countered that the self-media questioning was merely market speculation, lacking official authority, and that Kangmei Pharmaceutical's denial of fraud at the time did not eliminate the impact of the false information, therefore it could not be considered a "valid disclosure." Ultimately, the judicial authorities, considering the continuity of the manipulation, determined that Kangmei Pharmaceutical's announcement on April 30, 2019, regarding the correction of prior accounting errors, voluntarily admitting to an overstatement of nearly 30 billion yuan in cash, [3] constituted a formal and explicit disclosure of the core carrier of the manipulation (false financial information), and that date was the disclosure date. The controversy raises the question of whether questioning from informal sources constitutes an "effective disclosure" of manipulation, and whether the determination

of the disclosure date should focus on "market reaction" or "the authority and certainty of the information."

### **3.3. Disputes over the determination of the causal relationship between manipulation and investor losses**

This dispute directly relates to the scope of civil compensation for the manipulator, with the core issue being whether the investors' losses were directly caused by the manipulative behavior in question. The two sides present diametrically opposed arguments: Kangmei Pharmaceutical argues that some investors continued to buy shares after questions were raised by social media in October 2018, and that the company had issued relevant risk warnings; therefore, the investors' actions constituted "voluntary risk-taking," and their losses were not causally related to the manipulative behavior. The investors, on the other hand, argue that the manipulative behavior was continuous; from 2016 to April 2019, the false financial information was never formally disclosed; investors bought shares based on reasonable reliance on the listed company's public information, and their losses stemmed directly from the inflated stock price caused by the manipulative behavior, and the subsequent stock price crash after the information was disclosed. The judiciary ultimately adopted the "presumption of reliance" principle, clarifying the standards for determining causation: First, the time requirement—investors must have purchased the shares in question between the date of the manipulation (2016) and the date of disclosure (April 30, 2019); second, the loss requirement—investors must have incurred losses by selling the shares or continuing to hold them after the disclosure date; third, an exception—if Kangmei Pharmaceutical can provide evidence that investors knowingly purchased the shares despite the company's fraudulent activities, it can be exempted from corresponding liability for compensation. Essentially, the core of this dispute lies in how to balance the investor's "duty of care" with the manipulator's "liability for compensation" in the context of established market manipulation.

## **4. Case Issues Analysis**

### **4.1. Of securities market manipulation**

Based on the judicial rulings in this case and securities regulatory practice, the determination of securities market manipulation must adhere to three core elements: subjective intent, objective conduct, and harmful consequences. These three elements are interdependent and indispensable, forming a complete qualitative logic. Subjective intent, as the core subjective element, requires clear evidence to prove that the perpetrator had the direct intention to "influence securities prices, mislead investors, and obtain illegal profits." In this case, the meeting minutes, fund flow records, and falsification instructions of Ma Xingtian et al. form a complete chain of evidence, directly confirming their intention to manipulate. At the objective conduct level, the perpetrator must have engaged in manipulative behavior that complies with the provisions of the Securities Law of the People's Republic of China. In this case, the combination of "falsification + market manipulation" misled the market by fabricating false information and manipulated transactions by leveraging financial advantages, meeting the legally prohibited manipulation scenarios, and is supported by objective evidence such as transaction records and carriers of false information. Harmful consequences are the substantive element of the determination; the manipulative behavior must reach the standard of disrupting the securities market order and causing significant losses to investors. In this case, the manipulation led to a sharp drop in stock prices, directly causing 52,000 investors to suffer a total loss of 2.459 billion yuan, resulting in severe damage. In summary, Kangmei Pharmaceutical meets all three of the above requirements, and its actions constitute manipulation of the securities market can be legally established.

## 4.2. For Securities Market Manipulation

Can skepticism from informal sources constitute "effective disclosure" of manipulation? And should the determination of the disclosure date focus on "market reaction" or "the authority and certainty of the information"? First, skepticism from informal sources generally does not constitute "effective disclosure." According to the "Several Provisions of the Supreme People's Court on the Trial of Civil Compensation Cases Arising from False Statements in the Securities Market," effective disclosure requires both a carrier and an effect. Informal sources, such as self-media, lack the qualifications of legally authorized disclosure entities and the review mechanisms of legal channels, inherently lacking authority. In the Kangmei case, the self-media skepticism in October 2018 was merely a vague conjecture, failing to provide core evidence of the 30 billion yuan overstatement, and the company immediately denied it. The impact of the false information was not eliminated, failing to achieve the effect of "substantial warning." Judicial data shows that only 8% of judgments recognize the media disclosure date, the core reason being insufficient authority. Second, the determination of the disclosure date should adhere to the principle of "prioritizing authority and certainty, while also considering market reaction." The securities market relies on a true and accurate information environment, and the legislative purpose of the Securities Law dictates that the disclosure date should aim to eliminate false information and provide definitive evidence. The correction announcement issued by Kangmei on April 30, 2019, was released by a legally authorized entity through legal channels, explicitly acknowledging the core facts of financial fraud. It possesses complete authority and certainty, meeting the core requirements for a disclosure date. Market reactions only provide supplementary verification. Stock price fluctuations are influenced by multiple factors. The limit-down price drop following media questioning in the Kangmei case was actually short-term panic, and the subsequent stock price rebound confirmed its lack of sustained warning effect. The continued sharp decline after the announcement, however, validated the market effect of effective disclosure. In summary, informal information sources must meet stringent conditions such as nationwide influence and clearly pointing to core facts to become exceptions; the core of determining the disclosure date is the authority and certainty of the information. This aligns with the logic of determining liability for manipulation and meets the fundamental needs of investor protection and market regulation.

## 4.3. Regarding the determination of the causal relationship between manipulation and investor losses

In the context of established market manipulation, balancing investors' "duty of care" with the manipulator's "liability for compensation" hinges on the dual objectives of "protecting investors' legitimate rights and interests" and "preventing excessive accountability," using judicial standards to clarify the boundaries of rights and responsibilities. First, it is crucial to prioritize defining the core liability of the manipulator, as their manipulation of market prices through false information and other means undermines market trust and is the root cause of losses. Therefore, the judiciary adopts the "presumption of reliance" principle, presuming that investors' purchase of stocks based on reliance on publicly available information is reasonable. As long as the requirement of "purchase during the manipulation period and loss after disclosure" is met, a causal relationship can be established. This reflects strict regulation of manipulation and strengthens the manipulator's liability for compensation. Secondly, it is necessary to reasonably set investors' duty of care, not to exempt them from their basic due diligence obligations, but to avoid shifting excessive responsibility onto them. Kangmei Pharmaceutical's claim of "buying despite being questioned by self-media" cannot be directly considered "voluntary liability." This is because self-media information is not officially disclosed and does not constitute a legally mandated situation requiring investors to bear a higher duty of care. However, if the manipulator can prove that the investor knowingly bought

the fraudulent material, they can be exempted from liability. This exception defines the boundaries of investors' duty of care and avoids a "one-size-fits-all" approach to liability determination. Overall, this balanced logic reduces the burden of proof for investors by presuming reliance, aligning with the information asymmetry between investors and listed companies, while providing reasonable defenses for manipulators through exception clauses, achieving a balance of rights and responsibilities and maintaining market fairness and order.

## **5. Suggestions for Improving the Legal Regulation of Securities Market Manipulation in my country**

### **5.1. Refine the criteria for identifying securities market manipulation.**

First, clarify the rules for identifying new types of manipulation. For new combined manipulation models such as "financial fraud + related-party transactions" and "manipulation under the guise of market capitalization management," issue specific judicial interpretations to clarify their constituent elements and identification standards, avoiding arbitrariness in judicial determinations. Second, refine the definition standards for "capital advantage" and "shareholding advantage." Based on the actual situation of my country's capital market, clarify the specific thresholds for capital ratio and shareholding ratio, while also considering factors such as transaction amount and frequency to comprehensively determine whether a capital advantage or shareholding advantage has been established. Finally, clarify the scope of "false information," distinguishing between general misleading information and manipulative false information, and specifying the specific conditions under which fabricating and disseminating false information constitutes market manipulation.

### **5.2. Improve the rules for determining the date of disclosure of manipulative behavior.**

It is recommended that judicial interpretations be used to clarify the criteria for determining the disclosure date of securities market manipulation, establishing the basic principle of "prioritizing authority and certainty while taking market reaction into account," and refining specific rules for determination. On the one hand, the elements constituting valid disclosure should be clarified, including the legal status of the information disclosure entity, the clarity and authenticity of the information content, and the official nature of the disclosure channel. Strict conditions should be set for informal information sources to constitute valid disclosure, such as having nationwide influence, providing sufficient supporting evidence, and being able to eliminate the impact of false information. On the other hand, the methods for determining the disclosure date should be clarified in different situations: for official disclosure, the disclosure date should be used; for disclosure by informal sources followed by official confirmation, the official confirmation date should be used; for disclosures by multiple sources, the earliest date reaching the valid disclosure standard should be used.

### **5.3. Optimizing the rules of proof for causal relationships**

To further improve the application rules of the "presumption of reliance" principle, its scope and conditions of application should be clarified, and application standards in judicial practice should be unified. First, the prerequisite for the application of the "presumption of reliance" should be clarified: investors must have purchased stocks between the date of the manipulation and the date of disclosure, and their purchase must have been based on reasonable reliance on publicly available information, <sup>[4]</sup> without any known manipulation. Second, the defenses and burden of proof for the manipulator should be clarified, and the evidentiary standards for exceptions such as "investors were aware of the manipulation" and "losses were caused by other factors" should be refined, allowing the manipulator to reasonably exercise its right to defense. Finally, a mechanism for supporting evidence of causation should be established,

clarifying that courts can, based on the circumstances of the case, order the manipulator to provide relevant evidence, such as fund flows, transaction records, and financial data, thereby reducing the burden of proof on investors.

#### **5.4. Strengthen regulatory coordination and improve regulatory effectiveness**

Regulating securities market manipulation requires multi-departmental collaboration to form a regulatory synergy. First, it is crucial to strengthen cooperation between the China Securities Regulatory Commission (CSRC) and judicial organs, establishing mechanisms for case transfer, information sharing, and joint case handling to improve the efficiency of case investigation and adjudication, ensuring that manipulative behavior is promptly and effectively investigated. Second, it is essential to strengthen collaborative supervision between the CSRC, stock exchanges, and intermediaries, <sup>[5]</sup> enhancing oversight of listed companies' information disclosure, related-party transactions, and fund flows to promptly detect and curb any signs of manipulation. Finally, strengthening investor education is vital to raise investors' awareness of risk prevention and rights protection, guiding them towards rational investment, while ensuring smooth channels, <sup>[6]</sup> for investor rights protection and providing convenient services.

### **6. Conclusion**

Securities market manipulation severely disrupts capital market order, infringes upon investors' legitimate rights and interests, and hinders the healthy development of the capital market. The Kangmei Pharmaceutical securities market manipulation case, a landmark case in the history of my country's capital market, clarified the standards for identifying securities market manipulation, the rules for determining the disclosure date, and the logic for judging causation during its trial, providing important judicial reference for the regulation of securities market manipulation in my country. At the same time, this case also reflects the shortcomings of my country's current legal regulatory system for securities market manipulation, such as insufficiently detailed identification standards, inadequate rules for determining the disclosure date, insufficiently optimized rules for evidence, and an incomplete legal liability system. Improving my country's legal regulatory system for securities market manipulation requires basing it on the actual situation of my country's capital market, combining the judicial experience of the Kangmei Pharmaceutical case, refining the standards for identifying manipulation, improving the rules for determining the disclosure date and causation, strengthening regulatory coordination, and forming a comprehensive and multi-layered regulatory system. Only in this way can securities market manipulation be effectively curbed, the fairness, impartiality, and openness of the capital market be maintained, the legitimate rights and interests of investors be protected, and the healthy and orderly development of my country's capital market be promoted.

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