UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

ADMINISTRATIVE PROCEEDINGS RULINGS
Release No. 3792/April 20, 2016

ADMINISTRATIVE PROCEEDING
File No. 3-17112

In the Matter of FRAZER FROST, LLP, SUSAN WOO, CPA, and MIRANDA SUEN, CPA	ORDER REGARDING JUDICIAL ESTOPPEL

Respondents have moved to dismiss on the basis of judicial estoppel. I construe their motion to dismiss as a motion in limine and grant it in part. The prior factual allegation that forms the basis for Respondents' motion may be offered as substantive evidence.

Background

The Commission initiated this proceeding in February 2016 when it issued an order instituting proceedings (OIP). In the OIP, the Division of Enforcement alleges that Respondent Frazer Frost, LLP, is an audit firm and that Respondents Susan Woo and Miranda Suen were two of Frazer Frost's accountants. OIP at 2. The allegations concern Respondents' audit engagement with China Valves Technology, Inc. *Id.* at 2-3. The Division claims Respondents "engaged in . . . improper professional conduct during their third quarter 2010 review of interim financial information and their 2011 year-end audit of China Valves." *Id.* at 2.

As is relevant to this order, the Division alleges that in October 2010, Respondents learned, via an e-mail from China Valves CEO Jianbao Wang, that in previous filings with the Commission, China Valves had misstated certain information related to its acquisition of certain assets. OIP at 4-5. According to paragraph fifteen in the OIP:

> Although Respondents verified during their 2010 third quarter review that the information in the Wang Email was correct and that [China Valves'] 2010 financial statements included in Forms 10-Q misstated the acquisition, Respondents failed to act in accordance with [the Public Company Accounting Oversight Board] interim review standards and recommend modifications to [China Valves']

> management or audit committee to make the Form 10-Q conform to Generally Accepted Accounting Principles ("GAAP").

Id. at 6.

Respondents take issue with the allegation in paragraph fifteen. They assert that in 2014, the Commission filed a complaint against China Valves, its Chairman, CFO, and Wang, its former CEO. Mot. at 1-2. According to Respondents, the Commission alleged in its complaint that "China Valves' auditors . . . recommended that [China Valves] make revisions to its third quarter Form 10-Q to correct its disclosure of the acquisition in response to information they had learned . . . but [China Valves] failed to make the recommended changes." *Id.* at 1-2 (second alteration in original). Respondents argue that, because the allegation in paragraph fifteen of the OIP "directly contradict[s]" the above allegation in the China Valves complaint, the doctrine of judicial estoppel bars the Division from raising the assertion in paragraph fifteen. *Id.* at 6-7. They therefore argue that the Division should "be estopped from asserting" that they "failed to recommend that China Valves make revisions to its third quarter Form 10-Q." *Id.* at 10.

In response, the Division does not deny that the allegation in paragraph fifteen of the OIP contradicts the above allegation in the Commission's complaint.[1] Instead, it says that paragraph fifteen represents "information [it] learned after the [China Valves] complaint was filed." Opp. at 3. The Division also argues that the requisites for invoking judicial estoppel are not met here because the allegation in the complaint was not judicially accepted or relied upon, the allegation in paragraph fifteen is based on new evidence, and the Division has not "realize[d] an unfair advantage." *Id.* at 9-11.

Discussion

In deciding whether to invoke judicial estoppel, courts ordinarily consider whether: (1) "a party's later position" is "'clearly inconsistent' with its earlier position"; (2) "the party has succeeded in persuading a court to accept that party's earlier position"; and (3) "the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped." *New Hampshire v. Maine*, 532 U.S. 742, 750-51 (2001). The federal government, however, is not an ordinary litigant. *Heckler v. Cmty. Health Servs. of Crawford Cty., Inc*., 467 U.S. 51, 60 (1984). Although the Supreme Court has never held that estoppel will not lie against the government, it has noted that it has "reversed every finding of estoppel [against the government] that [it] ha[s] reviewed." *OPM v. Richmond*, 496 U.S. 414, 422 (1990).

Assuming estoppel can lie against the government, it "will rarely work against the government" because "a private party trying to estop the government has a heavy burden to carry." *United States v. Morse*, 613 F.3d 787, 792 (8th Cir. 2010) (discussing judicial estoppel)

[1] Exhibit A to the Division's opposition is a copy of the Commission's complaint in the China Valves action. The allegation in paragraph thirty-two of the complaint is consistent with Respondents' representation of what the Commission alleged in the complaint. *See* Ex. A at 11-12.

(citation omitted). In the Ninth Circuit, where Respondents suggest they will seek review of an unfavorable decision, Reply at 3, litigants seeking to invoke estoppel against the government bear the burden to demonstrate the existence of four additional factors. They must first show "affirmative misconduct going beyond mere negligence." *Watkins v. U.S. Army*, 875 F.2d 699, 707 (9th Cir. 1989) (*en banc*). Litigants who pass this threshold must then show that "the government's wrongful act will cause a serious injustice[] and the public's interest will not suffer undue damage by imposition of the liability." *Id.* Finally, the litigants must show that as a result of the government's affirmative misconduct, they "lost . . . rights to which they were entitled." *Morgan v. Gonzales*, 495 F.3d 1084, 1092 (9th Cir. 2007) (citation omitted).

Although they suggest that the Commission's counsel in the China Valves district court action may have violated Rule 11 of the Federal Rules of Civil Procedure, Respondents do not directly attempt to show affirmative misconduct. Opp. at 6-7. They also do not address the remaining factors necessary to invoke estoppel against the government. Their judicial estoppel claim thus fails. *See Watkins*, 875 F.2d at 707; *see also Peacock v. United States*, 597 F.3d 654, 661 (5th Cir. 2010) (rejecting an attempt to invoke judicial estoppel because a litigant failed to prove affirmative misconduct); *State of Mich. v. City of Allen Park*, 954 F.2d 1201, 1217 (6th Cir. 1992) (same).

This does not end the matter, however. "The law is quite clear that" even a party's superseded "pleadings constitute the admissions of a party-opponent and are admissible in the case in which they were originally filed as well as in any subsequent litigation involving that party."[2] Assuming Respondents demonstrate its relevance, they may offer the referenced allegation in the Commission's complaint as substantive evidence that China Valves' "auditors recommended that [China Valves] make revisions to its third quarter Form 10-Q to correct its disclosure of the acquisition in response to information they had learned through the Wang Email, but [China Valves] failed to make the recommended changes." Ex. A at 11-12; *see Hardy v. Johns-Manville Sales Corp*., 851 F.2d 742, 745 (5th Cir. 1988) ("[T]here is a well-established rule that factual allegations in the trial court pleadings of a party in one case may be admissible in a different case as evidentiary admissions of that party."); *Williams v. Union Carbide Corp*., 790 F.2d 552, 556 (6th Cir. 1986). As substantive evidence, the allegation is subject to rebuttal like any other evidence and will be accorded weight in light of the context in which it was made and in the context of all other evidence admitted during the hearing.[3]

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[2] *United States v. McKeon*, 738 F.2d 26, 31 (2d Cir. 1984); *see State Farm Mut. Auto. Ins. Co. v. Porter*, 186 F.2d 834, 841 n.10 (9th Cir. 1950) (noting that "statements made in a superseded pleading are receivable in either the same or another suit as admissions of the party making them"); *see also Pope v. Allis*, 115 U.S. 363, 370 (1885) ("When a bill or answer in equity or a pleading in an action at law is sworn to by the party, it is competent evidence against him in another suit as a solemn admission by him of the truth of the facts stated.").

[3] *See 188 LLC v. Trinity Indus., Inc*., 300 F.3d 730, 736 (7th Cir. 2002) (stating "the amending party may offer evidence to rebut its superseded allegations"); *cf. Williams*, 790 F.2d at 556 ("The plaintiff's argument that the statements were made merely to preserve legal rights may be quite persuasive, but should have been made to the jury.").

Construed as a motion in limine, Respondents' motion is granted in part. The factual allegation in paragraph thirty-two of the Commission's complaint that forms the basis for Respondents' motion may be offered as substantive evidence.

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James E. Grimes
Administrative Law Judge