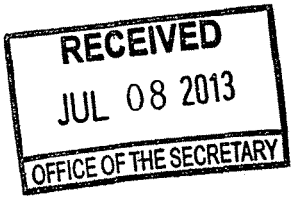
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING
File Nos. 3-14872, 3-15116




In the Matter of

BDO China Dahua CPA Co., Ltd.;
Ernst & Young Hua Ming LLP;
KPMG Huazhen (Special General Partnership);
Deloitte Touche Tohmatsu CPA Ltd.;
PricewaterhouseCoopers Zhong Tian CPAs Limited

Respondents.

The Honorable Cameron Elliot,
Administrative Law Judge

**REBUTTAL EXPERT DECLARATION OF JAMES V. FEINERMAN**

Respondents Dahua CPA Co., Ltd.; Ernst & Young Hua Ming LLP; KPMG Huazhen (Special General Partnership); Deloitte Touche Tohmatsu Certified Public Accountants Ltd.; and PricewaterhouseCoopers Zhong Tian CPAs Limited (collectively, "Respondents") hereby submit the Rebuttal Expert Declaration of their Chinese law expert, James V. Feinerman, attached hereto as Exhibit A.

Dated: July 1, 2013

Respectfully submitted,

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# EXHIBIT A

# Rebuttal Expert Declaration of James V. Feinerman

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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**REBUTTAL EXPERT DECLARATION OF JAMES V. FEINERMAN**
**JAMES M. MORITA PROFESSOR OF ASIAN LEGAL STUDIES**
**GEORGETOWN UNIVERSITY LAW CENTER**

I, James V. Feinerman, declare as follows:

1. I submitted a declaration pursuant to the order issued by Judge Elliot on May 29, 2013 and in support of Respondents Dahua CPA Co., Ltd., Ernst & Young Hua Ming LLP, KPMG Huazhen (Special General Partnership), Deloitte Touche Tohmatsu CPA Ltd., and PricewaterhouseCoopers Zhong Tian CPAs Limited on June 17, 2013. I submit this rebuttal declaration pursuant to the same order and in rebuttal of the Expert Report of Donald Clarke filed on June 17, 2013.

**Summary of Opinions**

2. The United States Securities and Exchange Commission ("SEC") and its Chinese law expert, Prof. Clarke, have asserted that the documents the SEC requested Respondents produce could have simply been turned over by a Chinese regulated entity, regardless of the legal and governmental realities that, in my opinion, are well understood by most experts familiar with PRC society and government. According to the analysis of the SEC and its expert, a Chinese party receiving a discovery request from a foreign governmental body could conduct its own determination of the applicability of various Chinese laws and regulations—including those having to do with data privacy, state secrets, and even the rules of procedure relating to

transnational discovery—and, after drawing the conclusion that none of the potential restrictions applied to it, transmit those documents beyond China's borders without ever discussing that request with its local regulator. I disagree with both the substance of this analysis and the reasoning process by which Prof. Clarke arrived at his conclusions.

3. The three decades of experience that Chinese and foreign lawyers have now had with the actual operation of the PRC legal order belies this naïve expectation, which seems to be rooted more in assumptions as to how private parties comply with the law in more established legal systems. Prof. Clarke's analysis of Chinese law in his Expert Report is based upon the assumption that statutory law in China operates similarly to statutory law in the United States. This analysis does not comport with the reality in China.

4. I will discuss four main reasons why this is the case:

   - China has a long standing and robust interest in protecting information and matters that relate to the State, including financial and accounting data that affects issues China views to be related to State interests. Although Prof. Clarke acknowledges that the release of state secrets carries with it criminal penalties, he ignores the overarching cultural, legal, and governmental importance of maintaining secrets, which is rooted both in conception of national sovereignty in China and the legal reality on the ground. His overly technical reading of the statutes attempts to find a way that Respondents might be able to produce documents directly to the SEC without authorization from Chinese agencies. Prof. Clarke's attempt fails not just because the statutes do not allow such production but also because the actual legal regime—aside from the statutes—prioritizes keeping sensitive information secret and would not allow production even if the statutes technically did. No reasonable actor in China would choose that path.

   - Prof. Clarke incorrectly asserts that Respondents could have gone to their local State Secrets Bureau ("SSB") offices, rather than to the CSRC, and received authorization to produce the documents requested directly to the SEC. This argument is undercut by the fact that KPMG Huazhen did just this, and authorization was denied. This argument also ignores the fact that China is extremely sensitive to its sovereign interests and that once another foreign government is involved in a matter, such as releasing potentially sensitive information, the matter must be dealt with on a national level. Indeed, as Prof. Tang makes clear in his Rebuttal Report, coordination among Chinese government entities is required of the CSRC and other government agencies by Regulation 29. Tang Rebuttal Report at ¶¶22-23.

- Prof. Clarke fails to address the CSRC's place in the Chinese legal and regulatory bureaucracy. As a part of a larger legal structure, the CSRC must coordinate with other agencies before authorizing the production of documents directly to the SEC. The CSRC has the authority to coordinate with the other Chinese agencies and to present those agencies' views and China's position to the SEC. However, without this coordination the CSRC cannot, by itself, authorize production. The coordination process leading to authorization by the Chinese government may also take longer and appear more complicated than U.S. companies or regulators are accustomed.

- Although Prof. Clarke acknowledges that oral directives can be binding law in China, his report does not affirmatively address the legal effect of oral directives here. This is a serious oversight because agency directives, such as oral directives, remain one of the most common forms of binding regulatory guidance in China. Respondents assert that they received both written and oral directives from the CSRC that they are not to produce documents directly to the SEC without prior authorization from the CSRC. In China, these directives are binding, and violation of these directives will result in penalties such as fines and increased regulatory hurdles.

5. My opinions are based on my experience with and study of Chinese law and the PRC government, my examination of relevant statutes and cases, documents I reviewed as listed in my Expert Report filed June 17, 2013, my interactions with Chinese and foreign experts in Chinese law, and my analysis of the Clarke Report.

**China Has a Long Tradition of Valuing and Safeguarding State Secrets and Sovereignty and Its Legal Regime Provides Broad Discretion to Enforce that Tradition**

6. Prof. Clarke recognizes the fact, as set forth in various Chinese statutes, that "[t]he unauthorized disclosure of state secrets can lead to criminal penalties." Clarke Expert Report at ¶ 23. However, he reads the statute as though Respondents were operating in a country with a rule of law and a tradition of statutory interpretation akin to that of the United States. He asserts that Respondents could, under the current regime and set of facts, simply review their documents sought by the SEC, determine which contain state secrets, mark those accordingly, and produce the remainder to the SEC without authorization from any Chinese agency. Clarke Expert Report at ¶¶20-21, 25. Aside from the fact that such a review and production would violate the CSRC's written directive (the "Reply"), Regulation 29, and could still violate the State Secrets Law, Prof. Clarke's analysis ignores the actual legal regime in China, China's sensitivity to protecting State Secrets and its sovereignty, and the real and serious risk to any company that ignores that actual legal regime.

7. As is well known by Chinese legal scholars and other observers, there exists in China a protective culture relating to information that deals with issues of the State, including business, financial, and economic information. This is not only a legacy of the Maoist era but also a remnant of centuries-old dynastic-era bureaucratic practice that still survives in China. The legal tradition in China results in a culture where government officials and others work by the guiding principle that everything is secret—disclosures are exceptions.

8. Aside from sanctions contained in Article 111 of China's Criminal Law for those who disclose state secrets, a large number of other statutes and regulations also contain provisions mandating secrecy. These include the Archives Law; Archives Law Implementation Rules; Regulations on Strengthening the Protection of Secrets and Archive Management Related to the Issuance and Listing of Securities Overseas; Securities Law; CPA Law; Accounting Firm Quality Control Principles No. 5101 – Business Quality Control; and CPA Ethics Regulation Guiding Opinion. The pervasiveness of these rules illustrates the overwhelming concern with non-disclosure of a wide range of materials that Chinese law deems "secret."

9. In general, Chinese statutes are written broadly to give a great deal of administrative discretion to Chinese agencies, enhancing their influence and their exercise of control over regulated entities. Accordingly, understanding Chinese law requires more than just reading of texts; it also requires experience with the practical realities of the implementation of those texts. This is especially true of statutes dealing with State secrets. This often results in a gap between what statutes say and how agencies enforce the statutes. As Prof. Clarke has correctly pointed out in the recent past:

> Any account of the legal system of the People's Republic of China must be prefaced by a warning of the need to distinguish between the formal system and what actually happens. Such a gap is of course present in some degree in all countries, but in many areas it is particularly broad in China. Thus, while it may often be possible to provide a reasonably complete account of Chinese law as it applies to a certain issue, that will not be the same as a reasonably complete account of how a certain issue is in fact treated in China.[1]

10. Prof. Clarke's report does exactly what he cautions against. In his attempt to find some theoretical roadmap whereby Respondents might be able to produce the documents in question, he has focused on the "law as it applies to a certain issue" but has largely ignored and failed to provide "a reasonably complete account of how a certain issue is in fact treated

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[1] Donald C. Clarke, *The Chinese Legal System*, http://docs.law.gwu.edu/facweb/dclarke/public/ChineseLegalSystem.html. July 4, 2005.

in China." In fact, in light of overwhelming cultural and legal norms in China, to say nothing of the statutes and CSRC Reply that forbid disclosure here, companies would take on an enormous level of risk if they chose, without official notice or sanction, to review and determine what documents did and did not contain state secrets and then produce those they determined safe to a foreign regulator. Even if a company were able to find a way to do so without violating the exact letter of the written law, and Prof. Tang makes clear that there is no such way (Tang Rebuttal Report at ¶¶10-11, 24, 33, 36-37), the company would still run the enormous risk that Chinese agencies would take retaliatory legal and regulatory action against it in consequence of its decision. And if an agency later determined that the company's judgment on state secrets as to any of the documents produced were incorrect, the company would face severe penalties.[2]

**Once Legal Issues Involve Foreign Countries, Chinese Agencies Must Act with More Care**

11. Prof. Clarke next asserts that if Respondents were not comfortable reviewing documents themselves for state secrets and producing to the SEC, they could simply "go to [their] local branch of the State Secrets Bureau (the "SSB") and ask it to make a determination." Clarke Expert Report at ¶27. First, Prof. Clarke undercuts his own theory by pointing out that KPMG Huazhen did exactly that "but was turned down on the grounds that any request for a determination must be submitted by another Chinese government body." Clarke Expert Report at ¶28. Prof. Clarke appears to assert that KPMG Huazhen failed because his theoretical model of Chinese legal process is more correct than that employed by Chinese agencies. Clarke Expert Report at ¶29 ("It is worth noting that such a rejection seems contrary to Chinese law."). Second, Prof. Clarke ignores his well-stated view quoted above that the gap between what a Chinese statute in isolation appears to set forth on an issue and how that issue will actually be dealt with in China may be large. Third, Prof. Clarke fails to take into account the foreign involvement in this matter.

12. As I have stated previously, China has a strong view of its sovereignty and independence. This national view has developed over several centuries in response to various wars, invasions, and other threats to China's national interests. For this reason, as with most countries, purely domestic issues are treated differently than issues that involve another foreign power.

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[2] Prof. Clarke concedes just this danger when he states that "[t]he fact that material is not marked as a state secret does not guarantee that the authorities would not consider it a state secret" and "[t]he unauthorized disclosure of state secrets can lead to criminal penalties." Clarke Expert Report at ¶¶22, 23.

13. Once another foreign power is involved, China focuses on its sovereign interests. These Chinese concerns do not exist to the same extent when the issue is purely domestic. As Prof. Tang correctly points out, the relevant statutes here and the Reply are not blocking statutes, because they have domestic, as well as foreign implications. Tang Expert Report at ¶¶15, 58. However, interference from foreign powers in its domestic legal process can offend China's sovereign interests and can be viewed as a violation of those interests.

14. As the SEC acknowledged recently in an April 27, 2011 letter from former SEC Chairman Mary Schapiro to a member of Congress discussing the objections of the CSRC to SEC investigations seeking direct access to witnesses and documents in China and asserting that the SEC's efforts amounted to a "possible violation of sovereignty and/or national interest" in China.[3] PCAOB board member Lewis Ferguson also acknowledged China's focus on sovereignty. In a speech he explained that "any action by a foreign regulator on Chinese soil, even a mere inspection, could violate Chinese sovereignty. This concern has deep historical roots, specifically relating to the humiliations that China suffered at the hands of Western powers in the nineteenth and early twentieth centuries."[4]

15. Thus, when foreign interests are involved, Chinese agencies are far more deliberate in how they approach decisions they must make. Additionally, local agencies will defer to higher government agencies to make critical determinations. This is consistent with the national approach I have described. In fact, such coordination is contemplated by the Chinese securities laws and Regulation 29, which provide that the CSRC has the sole authority to interface with the SEC on these issues and the authority to coordinate among the various Chinese agencies tasked with working on this issue. Tang Rebuttal Report at ¶¶9, 23.

16. Just as Prof. Clarke convincingly argued during a panel at a 2010 Economist China Summit conference as reported on his blog:

> How can we predict what a particular official will do? Will we do a better job by looking at what the law says he should do, or by looking at the set of incentives he

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[3] April 27, 2011 letter from former SEC Chairman Mary Schapiro to The Honorable Patrick T. McHenry, Chair of the Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs of the House of Representatives Committee on Oversight and Government Reform, http://s.wsj.net/public/resources/documents/BARRONS-SEC-050411.pdf.

[4] Sept. 21, 2012 Speech at the California State University 11th Annual SEC Financial Reporting Conference in Irvine, CA, http://pcaobus.org/News/Speech/Pages/09212012_FergusonCalState.aspx.

faces that his superiors have set up for him? I believe that in China, the answer is overwhelmingly the latter. It's the immediate incentives that matter.[5]

17. The intersection of Chinese interests and foreign interests also increases the risk to companies and individuals operating in China. For instance, many of the most public State Secrets prosecutions in China involved such an intersection—individuals obtaining information on China interests, such as the steel industry, and sharing them with foreign actors.[6]

18. Here then not only is it completely improbable, but also demonstrably inaccurate, that a local Chinese agency, such as a local SSB, would ever authorize the production of documents directly to the SEC without, at the very least, coordinating with the CSRC or other national-level agency. It would also be very dangerous for a company to act without coordinating with the CSRC or other national-level agency when, as here, China's sovereign interests are implicated.

**The CSRC Operates Within a Structured Bureaucracy**

19. Not only are Chinese agencies generally required to coordinate, especially once another foreign government is involved in the issue, but the CSRC is also specifically mandated by statute, along with other Chinese agencies, to coordinate on the issue of foreign document production. Prof. Clarke fails to address this important issue of Chinese law—the impact of the CSRC's place in China's bureaucratic structure. On the one hand, the CSRC is the administrative counterpart to the SEC, the "face" of China to the outside world as far as securities regulation matters are concerned. On the other hand, it must operate within a domestic bureaucratic structure where it has to negotiate with several (including higher ranking) governmental units, which limit its freedom to acquiesce to SEC demands.

20. This aspect of the Chinese regulatory and legal structure leads to two results relevant to this proceeding. First, the CSRC coordinates with other agencies, such as the SSB, in determining the extent of production of documents containing state secrets. *See* Tang Rebuttal Report at ¶¶22-24. Thus, it is incorrect to examine China's legal structure and

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[5] The Chinese Government's Evolving Relationship With Its Citizens Available, November 15, 2010 available at: http://lawprofessors.typepad.com/china_law_prof_blog/2010/11/the-chinese-governments-evolving-relationship-with-its-citizens.html.

[6] *See, e.g., China Jails U.S. Geologist for Stealing State Secrets*, BBC News (July 5, 2010), http://www.bbc.co.uk/news/10505350; John Lee, *The Uncurious Case of Xue Feng's Jail Sentence*, Forbes.com (July 7, 2010), http://www.forbes.com/2010/07/07/xue-feng-stern-hu-state-secrets-opinions-contributors-john-lee.html.

assert that the SSB would on its own authorize the production of audit workpapers directly to a foreign regulator. Second, it helps to explain the time and coordination necessary for the CSRC to respond to the SEC and coordinate with its U.S. counterpart.

21. First, Prof. Tang explains that following Article 7 of Regulation 29, the CSRC, SSB, State Archives Administration ("SAA"), and other agencies must set up a "coordinating mechanism" in regulating "matters involving protection of secrets and archive administration in the course of any overseas issuance and listing of the securities of an overseas listed company." Tang Rebuttal Report at ¶¶22-23 (quoting Article 7 of Regulation 29). This appears to be exactly what the CSRC has done in coordinating on the issue of producing the documents requested by the SEC and in taking the lead in interfacing with the SEC.

22. It would be a violation of Regulation 29 for a local SSB office or the SSB to authorize the production of the requested documents overseas directly to the SEC. It would also be a violation of Regulation 29 for the Respondents to produce the documents themselves without authorization of the CSRC. Prof. Clarke's analysis fails on these two issues, among others.

23. Second, the CSRC must coordinate with various Chinese agencies, some of which rank higher within the Chinese regulatory structure, before it can authorize production to the SEC. This must take place in a system where various Chinese agencies issue guidance and regulation that may be overlapping and may conflict with other agencies.

24. As a recent article in the Wall Street Journal points out:

> [The CSRC] also operates with institutional constraints that strictly limit its authority. Chinese law remains vague on who has ultimate responsibility for release of audit documentation on Chinese companies listed overseas; the CSRC is only one of several government bodies in the mix. The repercussions for CSRC officials if they overstep their bounds—especially in matters involving perennially testy Sino-American relations—could be severe. [7]

25. This structure and conflict leads to coordination and deliberation that is often far slower than that to which U.S. companies or regulators are accustomed. It also can result in agencies giving various and conflicting reasons for taking or not taking certain actions. The public

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[7] Rob Koepp, "The SEC's Misguided China Fight," The Wall Street Journal, April 25, 2013; http://online.wsj.com/article/SB10001424127887324474004578444391593168794.html?mod=wsj_streaming_stream.

conflict in reasoning often stems from internal deliberation amongst various Chinese agencies, each asserting various and differing reasons to take or not take certain actions.

26. As the analysis above makes clear, the CSRC is constrained by the nature of the Chinese bureaucracy and the complex relationship among the various government bodies with responsibility for oversight of not only the securities markets but also other sectors of China's national economy.

**Chinese Agencies Largely Govern through Robust and Binding Internal Directives**

27. As I stated in my previous Expert Declaration, "[t]he vast majority of administrative guidance provided by Chinese regulators to regulated entities is still largely unwritten or 'internal' (in Chinese '*neibu*')." Feinerman Expert Declaration at ¶37. Such unwritten or internal law can take the form of oral instructions from regulators. Prof. Clarke acknowledges that oral guidance from Chinese regulators can function as law, Clarke Expert Report at ¶44 n.28; however, he does not opine on such oral law in his Report. Clarke Expert Report at ¶44 (The Division has asked me to opine on whether, *apart from the above-referenced oral directions* that Respondents state they have received from the CSRC, Chinese law requires China-based accounting firms to notify and/or seek approval from the CSRC before producing documents directly to U.S. regulators in response to information requests.") (emphasis added).

28. The lack of analysis by Prof. Clarke regarding the binding oral instruction from the CSRC is glaring. Without taking into account unwritten or internal CSRC declarations, such as the CSRC's oral instructions, Prof. Clarke ignores one of the principal ways in which regulators, such as the CSRC, provide binding guidance.

29. When companies are determining what actions to take that may implicate Chinese law, they cannot do as Prof. Clarke suggests they might have done and simply ignore the unwritten or internal binding guidance from the relevant Chinese regulators. Just the opposite, Chinese statutory law must be interpreted in light of the binding guidance being received from the Chinese regulators. In some respects, this is similar, though not identical, to how U.S. companies often interact with U.S. regulators. In the U.S., regulated entities often seek advance clearance for significant acts from regulatory authorities. The procedures established by the SEC for corporations to seek "no-action" letters (http://www.sec.gov/answers/noaction.htm) or by the IRS for private letter rulings (*see, e.g.*, http://www.irs.gov/Tax-Exempt-Bonds/TEB-Private-Letter-Ruling:-Some-Basic-Concepts) provide a mechanism widely employed by regulated entities and their attorneys to ensure that

a planned course of action will not result in legal liability. The SEC similarly "encourages companies and their auditors to consult with the Office of the Chief Accountant on accounting, financial reporting, and auditing concerns or questions. (http://www.sec.gov/info/ accountants /ocasubguidance.htm). And, the Office of Corporate Finance "considers registrants requests for waivers and interpretations of SEC reporting requirements." (http://www.sec.gov/divisions/corpfin/cfreportingguidance.shtml). After receiving this guidance and on notice of the SEC's or the IRS's interpretation of the law or its view of relevant regulations, companies would take on enormous risk ignoring such guidance and going forward in a manner that contradicts the regulatory guidance. The difference here is that in China such guidance from a regulator is binding and moving counter to such guidance would not just be risky, it would incur penalties.[8]

30. I understand that here, the Respondents have asserted that the CSRC has directed the Respondents via oral communication and other correspondence not to produce documents.[9] Such oral guidance is binding on the Respondents. *See* Tang Rebuttal Report at ¶19. Violation of this guidance would incur penalties such as fines and increased regulatory hurdles.

31. The oral guidance received by the Respondents not only affects how Respondents must interpret statutes, it also affects how they interpret written directives from the CSRC. Both oral and written directives from regulators in China are binding and violation triggers penalties. As I've stated before, the mere fact that the CSRC issued binding written guidance to Respondents indicates that the CSRC is deeply interested in this issue and that it will enforce its directives. The oral communications Respondents received from the CSRC also reinforce the written directive and help to interpret it.

32. It is clear from its face that the letter issued by the CSRC on October 26, 2011 and titled "CSRC Official Reply Concerning the Provision of Audit Working Papers and Other File Documents Abroad by Some Accounting Firms" (the Reply) sets forth the CSRC's position

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[8] It is also worth noting that in the U.S. the "no-action" letters and other similar decisional documents from U.S. regulators are made public. Even though these types of regulatory action do not provide precedential value for other companies, they do create a record indicating how agencies interpret laws, rules, and regulations, which companies find very helpful in determining future courses of action. In fact, this is one of the very reasons U.S. regulators make such decisional documents public. Similar public guidance is not present in the Chinese system, creating far more uncertainty and risk.

9 Letter from Douglas R. Cox to Amy L. Friedman, April 29, 2011; Letter from Michael D. Warden to Marshall Sprung and Junling Ma, April 17, 2012; Letter from Geoffrey F. Aronow to Barry A. Kamer et al., March 27, 2012; Letter from Robert G. Cohen to Marc Johnson, May 25, 2012; Letter from Michael S. Flynn to John J. Kaleba, April 12, 2012.

that direct production of audit workpapers to foreign governments in either an administrative or judicial proceeding without approval of the Chinese government would be a violation of Chinese laws ("Any breach of the laws, rules and regulations, *including providing working papers and other documents without authorization*, would be held legally responsible by our relevant departments, according to the law.") (emphasis added). But even if it were not clear on its face, if the CSRC accompanied the written directive with oral instructions that documents were not to be produced without authorization, as Respondents assert, that oral instruction would have a binding effect on Respondents.

33. Ignoring the CSRC's internal law, whether oral or written, results in significant risk. The CSRC's internal directives are binding, and the CSRC is authorized to enforce penalties for any breach. Companies operating in China violate these directives at their own risk.

**The Declaration of Professor Xin Tang**

34. I have examined the statutes, regulations, and cases Professor Tang cites in his Rebuttal Report and have reviewed the opinions he has presented about them with respect to their content and their interpretation as a matter of Chinese law. Based on that review and my own prior knowledge of the Chinese legal system, I agree with the conclusions he has drawn and the opinions he has rendered.

*[Remainder of page intentionally left blank]*

I declare under penalty of perjury of the laws of the United States that the foregoing is true and correct.

Executed on July 1, 2013 in Bethesda, Maryland.

James V. Feinerman

James V. Feinerman