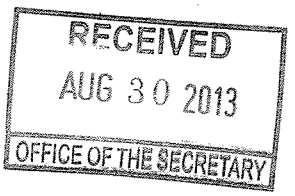
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



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 CERTIFIED PUBLIC ACOUNTANTS LTD., and PRICEWATERHOUSECOOPERS ZHONG TIAN CPAs LIMITED	:	The Honorable Cameron Elliot, Hearing Officer

DIVISION OF ENFORCEMENT'S POST-HEARING BRIEF

David Mendel (202) 551-4418
Amy Friedman (202) 551-4520
Douglas Gordimer (202) 551-4891
Marc E. Johnson (202) 551-4499
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-5971

COUNSEL FOR DIVISION OF ENFORCEMENT

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The Division of Enforcement (the "Division") of the U.S. Securities and Exchange Commission ("SEC" or "Commission") respectfully submits this Post-hearing Brief.

PRELIMINARY STATEMENT

Respondents are public accounting firms based in the People's Republic of China ("China" or "PRC").[1] They have chosen voluntarily to participate in U.S. capital markets by registering with the Public Company Accounting Oversight Board ("PCAOB" or "Board") and performing audit work for clients that issue securities traded in the U.S. Despite this, Respondents have failed to comply with U.S. statutory requirements that expressly apply to them by virtue of their affirmative conduct. Specifically, each Respondent has declined to produce audit workpapers and related documents for certain U.S. issuer-clients in response to Commission requests under Section 106 of the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or "the Act"), as amended by Section 929J of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") ("Section 106"). Respondents contend that producing the requested documents would subject them to possible penalties under Chinese law, a circumstance that they acknowledge they have known about at least since they first registered with the Board between 2004 and 2006. Ostensibly to avoid these alleged penalties, Respondents have chosen to deny the Commission access to documents to which it is statutorily entitled, and which the Commission has needed to conduct ongoing investigations and to

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[1] Order on Motions For Summary Disposition As To Certain Threshold Issues (Apr. 30, 2013), at 2 ("April 30 Order"). Respondents are BDO China Dahua CPA Co., Ltd. (now known as Dahua CPA Co., Ltd.) ("Dahua"), Deloitte Touche Tohmatsu CPA Ltd. (now known as Deloitte Touche Tohmatsu CPA LLP) ("DTTC"), Ernst & Young Hua Ming LLP ("EYHM"), KPMG Huazhen (Special General Partnership) ("KPMG Huazhen"), and PricewaterhouseCoopers Zhong Tian CPAs Limited ("PwC Shanghai"). At the time these proceedings commenced, each Respondent was a member of a global network of accounting firms. April 30 Order at 2. Dahua now represents that it is neither associated with nor a member firm of BDO International Limited. *See* Dahua Notice To All Parties (Jun. 7, 2013).

supervise accounting professionals who are registered with the Board and whose work is incorporated into Commission filings and relied upon by U.S. investors.

Respondents contend that the above-described status quo, under which, in the firms' view, they may freely avail themselves of the financial and reputational benefits of participating in U.S. markets while relying on the supposed restrictions of foreign law to exempt themselves from U.S. rules, is allowed by Sarbanes-Oxley. The Division disagrees. Respondents' decisions to enter U.S. markets and willfully refuse to comply with the SEC's requests under Section 106 (the "Requests") violated Sarbanes-Oxley. This Court can and should impose an appropriate remedy that addresses these violations and prevents future harm to Commission processes and U.S. investors caused by the firms' failures to produce the critical requested documents.

Under Rule 102(e)(iii) of its Rules of Practice, which Sarbanes-Oxley codified, "[t]he Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . [t]o have willfully violated . . . any provision of the Federal securities laws or the rules and regulations thereunder." 17 C.F.R. § 201.102(e)(iii); *see also* 15 U.S.C. § 78d-3(a)(3). Sarbanes-Oxley Section 106(e) provides that "[a] willful refusal to comply" with a Section 106 request "shall be deemed a violation of this Act." *Id.* § 7216(e). Respondents' knowing failures to produce requested documents constituted willful refusals to comply with the Requests, and thus were willful violations of the Act. The Commission should remedy Respondents' illegal conduct, and mitigate future harms to the Commission's processes and investors, by denying Respondents the privilege of appearing or practicing before it.

This ALJ can and should find that Respondents willfully refused to comply with the Requests based on what are essentially undisputed facts. Respondents undeniably entered U.S.

markets knowing they could be required to produce documents to U.S. regulators, and, by their own interpretations of Chinese law, could face sanctions from Chinese authorities for complying with such requests. Respondents further confirmed their knowledge of U.S. obligations when, after Congress amended Section 106 in 2010, they designated U.S. agents for receipt of service of document demands (including the ones at issue in these proceedings) as required by the amendment. Respondents also continued to accept audit engagements with U.S. issuers after the 2010 amendments. Given all of this voluntary conduct, their knowing refusals to comply with the Requests were "willful" under Section 106, because Respondents "intentionally committ[ed] the act[s] which constitute[d] the violation[s]." *Wonsover v. SEC*, 205 F.3d 408, 414 (D.C. Cir. 2000). The exact nature of the constraints imposed on Respondents under Chinese law, and their various communications with Chinese regulators about U.S. regulators' requests for documents – both before and after Respondents received the Section 106 requests – are irrelevant to the willfulness inquiry under Section 106.

The hearing record soundly confirms these grounds and establishes additional factual bases for Respondents' liability under Sarbanes-Oxley Section 106(e). Specifically:

- Respondents uniformly confirmed that they knew when they first registered with the PCAOB, and when they subsequently accepted U.S. issuer audit engagements, that Chinese law might impair their ability to comply with U.S.-law obligations to produce documents to their U.S. regulators.
- Respondents confirmed that they chose to comply with the alleged dictates of Chinese law, rather than with their obligations to produce documents under U.S. law.

- The purported Chinese legal regime that Respondents chose to follow was designed to block, and in fact did block, the SEC's access to audit workpapers. Respondents complied with a purported regime that simultaneously refused to provide assistance to the SEC under existing international protocols, thereby exerting its sovereign power and effectuating a total blockade against the SEC.
- Protection of state secrets was at most a (distant) secondary concern. Only a few documents sought by the Requests have been determined to contain state secrets.
- The *only* express legal prohibition on Respondents' production of documents to the SEC without authorization from the China Securities Regulatory Commission ("CSRC") consisted of the CSRC's alleged oral directives. Respondents' only proof of these directives is their own hearsay testimony. As the Division argues, this is an insufficient basis on which to prevent the SEC from remedying the severe harm to its processes, caused by Respondents' noncompliance.

All of these facts further support the conclusion that Respondents willfully refused to comply with the Requests under Section 106(e).

Contrary to Respondents' arguments, comity considerations do not require a different liability standard under Section 106(e). Nor does comity require application of factors that a court might consider when deciding whether to enforce a document request in light of foreign law concerns. Comity has no role in these proceedings, because the Division seeks only to achieve a remedy centered on the protection of SEC processes *in the United States*. The ALJ, of course, already has ruled that the Division does not seek to "enforce" the Section 106 requests through these proceedings. Thus, the Division does not seek to have Respondents violate any foreign law, and no sovereign interest of a foreign country is implicated. The only possible

"hardship" to Respondents is the removal of a benefit that they assumed for themselves when they voluntarily entered U.S. markets.

In any event, even if the ALJ does apply a stricter willfulness standard as urged by Respondents or engage in a balancing of the comity factors under the Restatement of Foreign Laws, the hearing record yields no different result. In addition to the above-listed facts, the record shows that Respondents have not acted in good faith, because (among other reasons) they "deliberately courted" the very legal impediments of which they now complain. *Société Internationale Pour Participations Industrielle et Commerciales v. Rogers*, 357 U.S. 197, 208-209 (1958). Respondents (among their other actions) entered the U.S. markets – and profited thereby – with full knowledge that they might well find themselves in this predicament. Furthermore, the record demonstrates that the United States has strong interests in both (1) obtaining the requested documents for the SEC's enforcement investigations, and (2) preventing its regulatory oversight of markets from being interfered with in the future. Either such interest far outweighs the Chinese government's interest in asserting its sovereignty through indeterminate secrecy laws or *ad hoc* and non-public directives expressly intended to block the SEC.

Assuming, *arguendo*, China *could* have a legitimate interest in channeling all information requests of foreign securities regulators through the CSRC, the SEC's actual experience with the CSRC over the last several years belies such an interest. As witness testimony conclusively established, the SEC requested the CSRC's assistance with respect to DTTC's audit workpapers for DTTC Client A over *three years* ago; and although the CSRC has had the documents in its possession for virtually this entire time, to date it still has not produced any of these documents to the SEC. As the hearing commenced this past July, the CSRC for the first time produced audit

workpapers, for an unrelated investigation (*i.e.*, the Longtop Financial Technologies Limited ("Longtop") investigation), to the SEC. Even assuming these documents were relevant to any of the investigations underlying these proceedings (which they are not), this production does not exonerate Respondents' willful refusals to comply with the Requests. Furthermore, that production does not now mitigate the remedy required to address Respondents' willful violations.

For these and other reasons discussed below, the Court should find that Respondents willfully violated the securities laws under Rule 102(e) by willfully refusing to comply with the Section 106 requests. The Court should also impose an appropriate remedy. Respondents' willful violations have severely harmed Commission processes by egregiously disrupting 10 enforcement investigations involving potential financial fraud, and in some cases apparently thwarting them altogether. These severe harms appear to have little chance of abating, as Respondents continue to perform audit work for U.S. issuers with no intention of complying with their production obligations under Section 106. This ALJ should censure Respondents and permanently deny them the privilege of appearing or practicing before the Commission through activities that consist of (1) issuing audit opinions filed with the Commission, or (2) playing a 50% or greater role in the preparation or furnishing of audit opinions filed with the Commission.

STATEMENT OF FACTS

I. Sarbanes-Oxley Establishes Registration And Document Production Requirements For Audit Firms

In 2002, Congress enacted Sarbanes-Oxley to combat fraud and enhance transparency after a series of massive corporate scandals shook public confidence in the U.S. capital markets. Sarbanes-Oxley "has been called the 'most radical redesign of the federal securities laws since the 1930s' and 'the most sweeping legislation affecting accounting, disclosure and corporate

governance in a generation.'" David M. Stuart & Charles F. Wright, *The Sarbanes-Oxley Act: Advancing the SEC's Ability to Obtain Foreign Audit Documentation in Accounting Fraud Investigations*, 2002 COLUM. BUS. L. REV. 749, 750 (quoting sources).

Sarbanes-Oxley created the PCAOB and subjected it to Commission oversight. 15 U.S.C. §§ 7211, 7217. The Act requires public accounting firms to register with the Board if they prepare or issue, or participate in the preparation or issuance of, any audit report with respect to any issuer. *Id.* § 7212(a). Once registered, firms are subject to comprehensive Board oversight, including inspections, investigations, and a reporting regime. *Id.* §§ 7212(d), 7214, 7215. Recognizing that audit firms' documents (including specifically workpapers) are critical to Board oversight, the Act authorized the Board to create rules requiring their retention, availability, and production, *id.* §§ 7214(d), (e), 7215(b)(2), and to suspend or revoke firms' registrations upon their failure to produce documents in connection with a Board investigation, *id.* § 7215(b)(3)(ii). The Board has issued such rules. *See* Board Rules 5103(a) & (b), 5110(a), 5200(a)(3), 5300(b).

Section 106 of Sarbanes-Oxley specifically addresses the registration status of foreign public accounting firms ("foreign firms")[2] and the obligations of firms, both foreign and domestic, to produce foreign firms' documents. Section 106(b) requires any foreign firm that engages in certain specified activities (*i.e.*, "triggering conditions") to produce documents directly to either the Board or the Commission upon request. *Id.* § 7216(b)(1). Section 106(e) provides, "A willful refusal to comply, in whole or in part, with any request by the Commission or the Board under this section, shall be deemed a violation of this Act." *Id.* § 7216(e).

[2] The Act defines "foreign public accounting firm" to mean "a public accounting firm that is organized and operates under the laws of a foreign government or political subdivision thereof." 15 U.S.C. § 7216(g).

II. Respondents Have Known At Least Since They Registered With The Board That They Are Required To Comply With U.S. Regulators' Demands For Documents

Respondents have known at least since the time they registered with Board that (1) they are required to comply with document demands from U.S. regulators, including the SEC, with respect to certain audit work for U.S. issuers; (2) Chinese law may impair their ability to comply with such demands; and (3) Respondents bear the risk of any conflict of law caused by their audit work for U.S. issuers. Respondents' knowledge of these facts is demonstrated by the following:

First, Section 106, as enacted in 2002, stated that if a foreign firm "issues an opinion . . . contained in an audit report," or meets certain other criteria, the firm "shall be deemed to have consented (A) to produce its audit workpapers for the Board or the Commission in connection with any investigation by either body with respect to that audit report; and (B) to be subject to the jurisdiction of the courts of the United States for purposes of enforcement of any request for production of such workpapers." Sarbanes-Oxley Act of 2002 (Public Company Accounting Reform and Investor Protection Act), Pub. L. No. 107-204, § 106(b) (emphasis added) **(Division Hearing Exhibit No. 279) (hereinafter "ENF")**.

Second, as expressly authorized by Sarbanes-Oxley, the Board created rules that require audit firms to retain, make available, and produce audit workpapers. Board rules provide for possible suspension or revocation of firms' registrations upon their failure to produce documents in connection with a Board investigation. *See supra*, Statement of Facts Section I.

Third, the Board expressly informed Respondents when they first registered, between 2004 and 2006, that Respondents were responsible for complying with requests for information, regardless of possible impediments to production under Chinese law. In the Form 1 registration applications Respondents submitted, they left blank the consents requested by Exhibit 8.1 of the

form.[3] Respondents also provided with their Form 1s letters from foreign legal counsel contending that the firms would not be able to comply with the requested consents because of restrictions imposed by Chinese law. *See* Respondents' Form 1s **(ENF 2; ENF 4; ENF 5; Respondents' Exhibit ("RX") 1; RX 40)**.[4] However, upon approving the firms' registrations, the Board wrote a letter to each firm stating that the Board's approvals – despite Respondents' omissions of the consents – ***did not*** relieve Respondents of their obligations to comply with future information requests. The Board's letter stated, in relevant part:

> ***Moreover, the Board's approval of [the firm's] registration application despite [the firm's] failure to supply a "Consent to Cooperate with the Board" (Item 8.1 of Form 1) does not relieve [the firm] of the obligation to cooperate in and comply with Board demands (including for documents or testimony) and to enforce such cooperation and compliance by [the firm's] associated persons. If [the firm] prepares or issues, or plays a substantial role in preparing or issuing, an audit report with respect to any issuer (as "issuer" is defined in the Sarbanes-Oxley Act of 2002), U.S. law and the Board's rules impose cooperation and compliance requirements that apply to [the firm] despite the absence of a consent under Item 8.1.***

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[3] Exhibit 8.1 requested the applicant to consent or agree: (a) "to cooperate in and comply with any request for testimony or the production of documents made by the [Board] in furtherance of its authority and responsibilities under the Sarbanes-Oxley Act of 2002"; (b) "to secure and enforce similar consents from each of its associated persons as a condition of their continued employment by or other association with the firm"; and (c) "that cooperation and compliance, as described in the firm's consent in paragraph (a), and the securing and enforcement of such consents from its associated persons in accordance with paragraph (b), shall be a condition to the continuing effectiveness of the registration of the firm with the [Board]." *E.g.*, DTTC Registration Form 1, at 16, Ex. 8.1 **(ENF 2)**.

[4] As part of DTTC's Form 1, for example, DTTC's foreign legal counsel stated: "The requirement that the applicant cooperate in and comply with any request for testimony or the production of documents made by PCAOB under Item 8.1(a), will violate certain provisions of PRC Laws and Regulations which prohibit disclosure of documents obtained during professional work by a certified public accountant ('CPA'), including audit workpapers, in particular given that there are no express provisions in PRC law which exempt the applicant from compliance with its confidentiality obligations under relevant PRC Laws and Regulations in the event of a request from PCAOB or SEC." DTTC Form 1, at 212, 16 April 2004 Letter from Century-Link & Xin Ji Yuan Law Office ¶4.4.1(i) **(ENF 2)**. The Form 1s for the other Respondents contained similar statements from the Century-Link law firm. *See* EYHM Form 1, Legal Letter at 12 **(RX 1)**; KPMG Huazhen Form 1, at 32 **(ENF 4)**; PwC Shanghai Form 1, at 31 **(ENF 5)**; Dahua Form 1 **(Respondents' Exhibit 40)**.

See Board Letters to Respondents **(ENF 6-10)** (emphasis added). The Board's letter was consistent with the Board's rules, which did not allow a firm, once registered, to avoid cooperation obligations, even where the firm had omitted an advance cooperation commitment from its registration form.[5]

Additionally, in 2004, the Board issued guidance to Respondents emphasizing that failure to cooperate with the Board's production requests could subject a firm to disciplinary sanctions, including substantial civil money penalties and revocation of the firm's registration. This guidance stated:

> A registered firm's failure to cooperate with Board requests [for production of documents] in these contexts may subject the firm to disciplinary sanctions, including substantial civil money penalties and revocation of the firm's registration. In the staff's view, if a firm fails to cooperate with the Board, the fact that the firm has not obtained a client consent that might be necessary (under non-U.S. law) to allow the firm to cooperate is not a defense to a disciplinary action for failure to cooperate.
>
> As a practical matter, therefore, a firm must choose whether (1) to satisfy itself in advance that the non-U.S. client will provide any necessary consent if and when the Board demands documents or information concerning the client, (2) to proceed without such assurance and take a risk that it may later have to choose between providing information without the client's consent or facing a Board sanction for failing to provide the information, or (3) to decline the audit engagement. The Board has not attempted to dictate which of these choices a firm should make.

See PCAOB FAQs Regarding Issues Relating to Non-U.S. Accounting Firms, Item 4 **(ENF 11)**.

Respondents acknowledged during the hearing that they knew, at the time they registered with the PCAOB, that PRC law could inhibit their ability to comply with U.S. disclosure obligations. *See, e.g.*, Tr. 1329:2-1334:3 (Raymond Chao Testimony) (PwC Shanghai believed that PRC law could prohibit production of workpapers to SEC); 1655:12-1661:22 (Richard

[5] PCAOB Rule 2105 permitted a firm, under certain circumstances, to withhold certain information from the registration form itself, but not in response to any future information request from a regulator. *See* PCAOB Rule 2105(a), available at http://pcaobus.org/Rules/PCAOBRules/Pages/Section_2.aspx.

George Testimony) (same for DTTC); Tr. 1530:17-1531:20 (Alden Leung Testimony) (same for EYHM). Further, Respondents also acknowledged that they knew that the PCAOB rejected the idea that such legal impediments, if they existed, exempted Respondents from their production obligations. *See e.g.* Testimony of Alden Leung, EYHM:

> Q : And your firm understood from that letter that your legal opinion did not relieve your firm of providing documents and testimony to the PCAOB, correct?
> A: We understood the PCAOB's position but we expect that there would be a solution among or between the governments and indeed a solution has come down.
> Q: But you understood in 2004 the PCAOB's position, correct?
> A: Say that again.
> Q: You understood in 2004 that the PCAOB's position was that your legal opinion did not relieve your firm of its obligations to provide documents and testimony to the PCAOB upon request?
> A: Yes, we understood that.

Tr. 1504:5-20 (Leung). *See also* Tr. 1664:19-1665:3 (George) (DTTC understood that PCAOB did not believe purported Chinese law prohibitions against production of workpapers relieved DTTC of its production obligations under Sarbanes-Oxley).

Fourth, in 2010, as part of Dodd-Frank, Congress amended Section 106 to *expand* the production requirements of Section 106(b). *See* Dodd-Frank § 929J (relevant portion of amendment captioned "Expansion of Audit Information to Be Produced and Exchanged") **(ENF 277)**. In particular, the amended provision now contains additional triggering conditions for a foreign firm's production obligation, such as where the firm performs "audit work" and "interim reviews." *See* Order On Motions For Summary Disposition As To Certain Threshold Issues (April 30, 2013) ("April 30 Order"), at 11-13 (Dodd-Frank added triggering conditions, including performance of "audit work," to Section 106(b)). The amendments also added other important features to the provision, including: (1) the requirement that foreign firms that meet the triggering conditions (as Respondents do here) designate a U.S. agent for receipt of

information requests under Section 106 and service of process to enforce such request, 15 U.S.C. § 7216(d); and (2) "Sanctions" for "[a] willful refusal to comply, in whole or in part" with any such request, *id.* § 7216(e).

Fifth, after the 2010 amendments, all Respondents submitted designations of U.S. agents under Section 106(d), confirming their awareness of and consent to the revised production obligations of Section 106(b). *See* Certified copies of designations for multiple Respondents **(ENF 165-A)**; Certified copy of Deloitte designation **(ENF 337)**. *See also* Tr. 1346:8-1347:16 (Chao); 1515:10-1517:23 (Leung); 1677:25-1681:15 (George); 2248:12-2252:6 (Jacqueline Wong Testimony). Respondents further confirmed at the hearing that, indeed, they understood when they submitted these designations that PRC law could impair, wholly or in part, their ability to comply with their production obligations. *See, e.g.*, Tr. 1520:16-25 (Leung).

In sum, Respondents registered with the PCAOB and designated agents pursuant to Section 106(d), despite their belief that Chinese law could prevent them from complying with Section 106 requests. Also, at the times they took these actions, they knew that U.S. regulators took the position that supposedly conflicting Chinese law would not relieve Respondents of their production obligations. They were therefore fully aware, at least since 2006, that by performing audit work for U.S. issuers, they willfully placed themselves in a position where they might face irreconcilable obligations imposed by potentially conflicting legal regimes.

III. Respondents Participated Broadly in U.S. Markets

Despite their knowledge of U.S. production requirements and the possibility that Chinese law might impair compliance with those requirements, after registering with the Board, Respondents took on numerous audit engagements with companies whose securities are registered with the SEC and trade on U.S. exchanges. According to Respondents' annual reports filed with the Board within the last four years, Respondents have all prepared or furnished or

played substantial roles in the preparation or furnishing of audit reports for U.S. issuers. Specifically, in its Annual Report Form 2s for the years ending March 31, 2010, 2011, 2012, and 2013, KPMG Huazhen stated that it played a substantial role with respect to 24, 23, 25, and 21 audit reports, respectively. **(ENF 21-23, RX 582).**[6] The remaining Respondents issued audit reports for the following numbers of issuers (as the term "issuer" is defined by Board Rule 1001), respectively, during the years ending March 31, 2010, 2011, and 2012:

- Dahua: 3, 9, and 3 issuers **(ENF 12-14)**
- DTTC: 32, 45, and 45 issuers **(ENF 15-17)**
- EYHM: 11, 24, and 21 issuers **(ENF 18-20)**[7]
- PwC Shanghai: 17, 27, and 31 issuers **(ENF 24-26)**

In addition, [redacted] Respondents other than Dahua [redacted]. These documents show that [redacted]:

- [redacted]
- [redacted]

[6] PCAOB Rule 1001(p)(ii) defines "Play a Substantial Role in the Preparation or Furnishing of an Audit Report" to mean: "(1) to perform material services that a public accounting firm uses or relies on in issuing all or part of its audit report with respect to any issuer, or (2) to perform the majority of the audit procedures with respect to a subsidiary or component of any issuer the assets or revenues of which constitute 20% or more of the consolidated assets or revenues of such issuer necessary for the principal accountant to issue an audit report on the issuer."

[7] EYHM provided audit reports for an additional 20 issuers for the year ended March 31, 2013. *See* Form 2 **(RX 583)**. Dahua, DTTC, and PwC Shanghai's Forms 2 for this most recent year were not entered into evidence.

- [redacted]
- [redacted][8]

(ENF 170-189); *see also* Expert Report of Anthony Jordan, at 18 (filed 7/1/13) ("Jordan Initial Report") [UNDER SEAL]; Tr. 8:14-25 (Jordan) [UNDER SEAL] (chart on page 18 of Jordan Initial Report summarizes [redacted].

To this day, Respondents continue to take on audit work for U.S. issuers, notwithstanding the Wells notices in which the Division clearly expressed the belief that Respondents' willful refusals to comply with Section 106 constituted willful violations of the securities laws, and notwithstanding the subsequent OIPs.[9] Respondents thus continue to assume new document production obligations that, by their own admissions in this proceeding, they cannot meet.

IV. Respondents Knowingly Failed to Produce Documents in Response to Commission Requests Under Section 106

Starting in 2010, during a series of ensuing accounting fraud investigations, the Commission sought audit workpapers first from DTTC and then from each of the other Respondents. The Division made extensive efforts to obtain these documents, first through requests for voluntary production from Respondents and/or through assistance from the CSRC, and, when those attempts failed, by sending Respondents the Section 106 Requests. Each Respondent refused to comply with its statutory production obligations.

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[8] [redacted]

[9] Despite the Wells notices and the OIPs, Respondents still assert that the Commission has made no "objection" to Respondents' conduct. *See* Mot. to Quash Subpoena, at 9 (June 14, 2013) ("Respondents are more than willing to stipulate that they have, without any objection from the SEC or the PCAOB, continued to take on engagements involving U.S. issuers.")

A. DTTC, The First be Called Upon, Knowingly Failed To Produce Documents In Response To A Commission Request Under Section 106

DTTC Client A, a manufacturer of solar products, is incorporated in the Province of Ontario, Canada and has its principal operations and place of business in China. *See* Form 20-F (filed 4/26/13) **(ENF 124)**. DTTC Client A's securities are registered with the SEC under Section 12(b) of the Exchange Act and trade on NASDAQ. *Id.*

DTTC audited DTTC Client A's financial statements for the fiscal years ended December 31, 2008 and 2009, among other years, issuing unqualified audit opinions. *See* Forms 20-F (filed 6/8/09, 8/19/10) **(ENF 120-121)**; Tr. 56 (Laura Josephs Testimony). In 2010, the Division opened an accounting fraud investigation relating to revenue recognition issues at DTTC Client A during the period 2008 through 2010. Tr. 53:3-4; Tr. 54:8-12.[10]

In the course of its investigation, the Division sought, among other materials, documents from both DTTC Client A and DTTC. Tr. 57:2-7. DTTC Client A produced "a fair volume" of documents, including financial statements, internal correspondence and emails. Tr. 57:9-19. DTTC Client A never indicated that any of the documents contained state secrets or archives material under Chinese law. Tr. 57: 20-58:2. Nor did DTTC Client A withhold any documents based upon Chinese law. Tr. 58:3-5.

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[10] On June 1, 2010, DTTC Client A publicly disclosed that it was postponing the release of its full financial results for the first quarter ended March 31, 2010 and its quarterly conference call, scheduled for June 2, as a result of the commencement of an investigation by the Audit Committee of DTTC Client A's Board of Directors. *See* Form 6-K (filed 6/3/10) **(ENF 125)**. DTTC Client A disclosed that "the investigation was launched after the Company received a subpoena from the [Commission] requesting documents from [DTTC Client A] relating to, among other things, certain sales transactions in 2009." *Id.* On August 19, 2010, DTTC Client A filed its delayed Form 20-F in which it disclosed material weaknesses in its internal controls. (ENF 121). On August 20, 2010, DTTC Client A filed a Form 6-K, attaching a press release from the day before in which it disclosed that the company was revising its previously reported financial results for 4Q09, resulting in a reduction of net revenues of $32.8 million.

The Division sought from DTTC "workpapers and all related documents, including communications with their client," Tr. 59:7-8, for a number of reasons, but:

> Probably the most important reason that we ask for audit work papers has to do with assessment of liability. In the first instance, it's an assessment of liability of the issuer itself. Were they told that there were various problems and issues with the way they were doing things and certain assessments, and what did they do in response to those things? Did they lie to the auditors? Did they not tell them what they were doing? In those instances, you are getting an audit opinion that is not based on true facts.
>
> Or do you have an issuer who actually asked the question of the auditor, can I do it this way? Is this all right? And the auditor says, Yes, it is. That all factors into our assessment of liability.

Tr. 60:20-61:8.

The first step the Division took to obtain audit workpapers from DTTC was to issue a subpoena to Deloitte LLP, the U.S. member firm of the Deloitte global entity. **(ENF 129)**; Tr. 61:22-62: 9 ("You can't send requests directly into China, and we could send requests to Deloitte U.S., so we started there. They are affiliated. We thought that would be a good way to begin."). In response, Deloitte LLP informed the Division that it had not performed any audit work for DTTC Client A and that it could not assist the Division because DTTC and Deloitte LLP were "legally separate entities." Tr. 62:16-21. Instead, Deloitte LLP directed the Division to [redacted] an individual acting as a liaison for "the affiliate Deloitte entities." Tr. 62:23. The Division asked [redacted] to pass on the request for audit workpapers to DTTC to see if DTTC would provide the documents on a voluntary basis. Tr. 63:4-7. [redacted] did so, but informed the Division that DTTC would not provide the documents because of "various legal impediments." Tr. 63:7-10.

After learning that Deloitte LLP had performed "some sort of ministerial formatting type work" with respect to DTTC Client A, the Division sent a subpoena to Deloitte LLP seeking documents relating to that work and information relating to the identities of the DTTC partners

who had worked on audits of DTTC Client A. **(ENF 130)**; Tr. 68:10-18. Deloitte LLP provided a small number of documents, ***not*** audit workpapers, in response to the subpoena. Deloitte LLP refused to respond to certain of the requests, asserting that "[t]he DTT member firms are separate and distinct legal entities, and Deloitte LLP (including its subsidiaries) does not have possession, custody or control of any documents responsive to either the April 9th Subpoena or the June 8th Subpoena that might be maintained by [DTTC]." **(ENF 131)**; Tr. 69:2-9.

Because DTTC refused to provide voluntarily its audit workpapers, the Division sought the assistance of the SEC's Office of International Affairs ("OIA"). Tr. 64:9. In June 2010, OIA made a request for assistance to the CSRC pursuant to the International Organization of Securities Commissions ("IOSCO") Memorandum of Understanding ("MMOU"), to obtain DTTC's workpapers relating to the firm's audit of DTTC Client A's financial statements for 2008 and 2009. *See* **(ENF 192)**. But despite extensive efforts by OIA over the next three years, the Division never received the workpapers in response to the June 2010 request. *See infra*, Argument Section III.B.2; Tr. 65:22-24 (Josephs); Tr. 944 (Alberto Arevalo Testimony). In fact, it was not until March 2011 that the Division and OIA learned that the CSRC had had the Client A workpapers in its possession since approximately July 2010. Tr. 70:22-24 (Josephs); 972:15-21 (Arevalo).

In March 2011, pursuant to its authority under Section 106, as amended by Dodd-Frank, the SEC issued a Section 106 request to DTTC. Request **(ENF 127)**; Tr. 70:8-12 (Josephs). Despite its obligations under Section 106, DTTC still refused to provide the Division with the requested workpapers. Tr. 71:10-15. Instead, DTTC provided the Division with "a laundry list of possible PRC provisions that might prohibit turning over the documents." Tr. 71:25-72:2; correspondence **(ENF 128)**. Beyond generalized assertions of Chinese law impediments, DTTC

never provided any specificity as to how the audit workpapers requested in the Section 106 demand were state secrets or archive material under Chinese law. Tr. 72:15-73:5. There is no evidence, nor did DTTC ever represent, that it had consulted with DTTC Client A about whether the documents contained state secrets or attempted to get a determination from the Chinese State Secrecy Bureau ("SSB") as to whether the documents contained state secrets. Tr. 73:6-16. The Division has never received any documentation indicating that the requested audit workpapers actually have been designated as state secrets. Tr. 73:17-74:1.[11]

Consequently, in July 2011, the Division issued a Wells notice to DTTC. **(ENF 147).** The Division has explained:

> We had before us a – somewhat of a broader issue. Since [DTTC] was refusing to provide the documents and the CSRC was not proving to be a viable gateway to get the documents, we had sort of a live problem in that [DTTC] was going to continue to issue audit opinions, not just for this issuer, but for others, and presumably would have the same issue with those. So if anything occurred in those issuers, we would have the same problem again, and investors would be left with an audit opinion that had no transparency. So that was the point that we issued the Wells notice, we were considering all those issues and what to do.

Tr. 75:16-76:3. Despite the Wells notice, the Division still received no documents from DTTC.

B. Respondents Knowingly Failed To Produce Documents In Response To Nine Other Requests From The Commission Under Section 106

Not only were the Division and the Commission thwarted in their attempts to obtain audit workpapers in the DTTC Client A investigation; they were denied audit workpapers in nine other accounting fraud investigations involving China-based issuer clients of Respondents ("Clients"). As detailed below, after trying to obtain the workpapers on a voluntary basis in all but one of the investigations, the Commission sent the Requests to Respondents. Respondents acknowledged receipt of the Requests but in all instances refused to provide the required documents. Even after

[11] During the hearing, the Division learned for the first time that a small number of DTTC's audit workpapers for Client A had been determined to contain state secrets. *See* Tr. 1808:8-1809:12 (Chiu).

being issued Wells notices by the Division, Respondents continued to withhold documents, yet persisted in performing audit work for U.S. issuers.[12]

1. Dahua

Dahua Client A, a Nevada corporation with its primary operations in Fujian, China, purports to process, distribute, and sell seafood, marine catch, and algae-based drink products. *See* 10-K filed 3/26/13 **(ENF 30)**; 10-K filed 3/12/11 **(ENF 31)**. Dahua Client A's securities are registered with the Commission pursuant to Section 12(b) Exchange Act, *id.*, and began trading on the New York Stock Exchange ("NYSE") Amex on August 10, 2009. *See* Bloomberg Report **(ENF 33)**. Dahua audited the financial statements for Dahua Client A for the fiscal year ended December 31, 2010, among other years, issuing an unqualified audit opinion. April 30 Order at 2 n. 5; Tr. 614:15-615:21 (Daniel Weinstein Testimony); Form 10-K (filed 3/2/11) **(ENF 31)**.

In 2011, the Division opened an accounting fraud investigation relating to Dahua Client A's valuation of an asset acquired, in late 2009, through a related party transaction. Tr. 607:22-610:2; Form 8-K/A (filed March 16, 2010) **(ENF 36)**. During its investigation, the Division sought documents from Dahua Client A and Dahua. Dahua Client A produced the requested documents to the Division and did not withhold any documents because of any alleged Chinese law restrictions. Tr. 610:10-25.

In seeking to obtain Dahua's workpapers, in May 2011, the Division sent a voluntary request to Dahua relating to its audit of Dahua Client A. **(ENF 280)**; Tr. 616:8-618:14. Dahua refused to provide documents in response to the Division's voluntary request, citing Chinese law restrictions. Letter from Dahua **(ENF 282)**; Tr. 618:15-621:5. The Division sought additional clarification regarding the Chinese law impediments via a follow-up letter. **(ENF 283)**; Tr.

[12] *See* Wells Notices to Respondents **(ENF 140-147),** and Respondents' responding briefs and exhibits **(ENF 148-163).**

621:6-622:8. Dahua replied by e-mail reiterating its refusal to produce the requested documents, again citing to general provisions of Chinese law, including those relating to state secrets. **(ENF 284)**; Tr. 622:9-623:5.

Accordingly, on February 1, 2012, invoking its statutory authority, the Commission issued a Section 106 demand to Dahua seeking "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Dahua Client A] for the fiscal year ending December 31, 2010." **(ENF 34)**; Tr. 624:2-624:6, 625:6-626:15. Again, in response, Dahua refused to produce the requested documents, citing to Chinese law impediments. **(ENF 35)**; Tr. 626:16-634:11. However, Dahua never indicated that any of the requested documents actually had been determined to be state secrets. Tr. 631:19-632:3. Nor did Dahua ever indicate that it had consulted with Client A as to whether any of the requested documents contained state secrets or that it had tried to get approval from the Chinese government to produce the documents. Tr. 632:4-634:2. The Division has never received any documentation from the Chinese government indicating that the requested documents had been specifically designated as state secrets. Tr. 634:7-11.

In May 3, 2012, the Division issued a Wells notice to Dahua. **(ENF 140)**. Despite the issuance of the Wells notice, the Division never received the requested audit workpapers. Tr. 625:2-5. Without the workpapers, the Division has been unable to assess whether Dahua even examined the transaction at issue in its investigation. Tr. 634:12-635:5.

2. EYHM

EYHM was engaged to audit the financial statements of Client B for the fiscal year ended December 31, 2010, and of Client C for the fiscal years ended September 30, 2010 and 2011. April 30 Order, at 2 n. 5.

a. Client B

Client B, a Delaware corporation with its headquarters and principal operations in China, claims to be a leading developer, manufacturer, and distributor of organic compound fertilizers. *See* Exchange Act Rel. No. 68060 (10/17/12) **(ENF 48)**; Tr. 1730:12-15 (Randall Leali Testimony). Client B's common stock was registered with the SEC under Exchange Act Section 12(b) and listed on NASDAQ from September 2009 to July 2011.[13] Exchange Act Rel. No. 68060 **(ENF 48)**; Tr. 472:10-13 (Eric Hubbs Testimony).

From April 2008 through November 2010, Client B's financial statements were audited by Grobstein, Horwath & Company LLP and its successor firm, Crowe Horwath. *See* April 1, 2010 Form 10-K **(ENF 40)**; Form 8-K (filed 11/17/10) **(ENF 41)**. Crowe Horwath conducted its audit of Client B by using an affiliate located in Hong Kong to perform field work. Tr. 480:10-14 (Hubbs). In November 2010, Client B engaged EYHM as its independent auditor. Form 8-K (filed 11/17/10) **(ENF 41)**; Tr. 1730:16-1731:3 (Leali). During the course of its audit, EYHM became concerned about the integrity of EYHM's financial statements, which it raised with Client B's Audit Committee. *See* Form 8-K (filed 3/18/11) **(ENF 42)**; 1731:10-23 (Leali). Further, in February 2011, a shortseller published a research report about Client B alleging, among other things, that Client B had significantly overstated its operations. Tr. 1732:7-1733:4.

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[13] The Commission revoked the registration of Client B's securities previously registered under Section 12 of the Exchange Act on October 17, 2012. *See* Exchange Act Rel. No. 68060 (10/17/12) **(ENF 48)**

Client B's Audit Committee engaged EYHM to investigate the allegations in the shortseller report. Tr. 1733:5-13 (Leali). EYHM's inquiry raised considerable concerns about Client B's financial statements. On March 8, 2011, at a meeting with two members of the Audit Committee, EYHM discussed the findings and recommended that Client B conduct an independent investigation. Tr. 1733:14-1734:21; *see also* EYHM March 8, 2011 Powerpoint Presentation to Audit Committee (**ENF 49**). On March 13, 2011, in a press release, Client B stated that it had formed a special committee of its board to investigate allegations made by third parties. *See* Form 8-K (filed 3/16/11) (**ENF 43**). Yet Client B dismissed EYHM as its independent auditor on March 14. *See* Form 8-K (filed 3/18/11) (**ENF 42**). The following day, EYHM sent a Section 10A Report to Client B that described certain findings and its belief that the Company had not taken sufficient remedial action to address them. EYHM Section 10A Report re Client B (**ENF 45**).

In 2011, the Division opened an investigation into potential misconduct and accounting fraud at Client B. The Division's investigation related to allegations concerning: the existence of Client B's customers and suppliers, Client B's production capacity and revenue recognition, undisclosed related party transactions, internal control deficiencies and the fabrication, alteration, and destruction of company documents. Tr. 473:15-24 (Hubbs). In its investigation, the Division sought documents from Client B and audit workpapers from Client B's auditors. It was particularly important to the staff to obtain EYHM's audit workpapers to investigate the issues raised in its Section 10A Report. Tr. 492:23-25, Tr. 573:13-17 ("In a case where the auditor is actually making allegations [. . .] I believe it's even more important to get the workpapers and be able to review them. I don't think auditors make those types of allegations lightly.").

Client B produced a "substantial" number of documents, including business records, emails, and board documents. Tr. 474:21-475:6. Client B made no assertions that the documents contained any state secrets or withheld any documents based upon Chinese law restrictions. Tr. 475:7-16. Similarly, Crowe Horwath produced all of its audit workpapers to the Division, withholding no documents based upon Chinese law restrictions. Tr. 479:21-480:6-9.

The Division, however, was unsuccessful in its attempts to obtain EYHM's audit workpapers. The Division initially sought EYHM's workpapers first through a voluntary request in May 2011 to EYHM's U.S. affiliate, Ernst & Young LLP ("EYLLP") **(ENF 305)** and then through a voluntary request to EYHM through its U.S. counsel. **(ENF 306)**. However, EYHM refused to produce the audit workpapers in response to the voluntary request, citing state secrecy and other Chinese law restrictions. **(ENF 307)**; Tr.484:21-487:10.[14]

Because EYHM declined the Division's voluntary request, in April 2012, the Commission issued a mandatory demand under Section 106 for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client B] for the fiscal year ending December 31, 2010." **(ENF 46)**. EYHM, however, refused to comply with its production obligations, asserting that such production would violate Chinese law. *See* R. Cohen letter to M. Johnson (5/25/12) **(ENF 47)**; Tr. 490:2-491:1. Meanwhile, EYHM never indicated that it had ever consulted with Client B as to whether any of the documents sought by the request contained state secrets. Tr. 491:7-12. Nor did EYHM indicate that it had ever tried to get a determination from the Chinese government as to whether any of the documents requested contained state secrets. Tr. 491:13-18. In fact, EYHM never indicated that any of the specific

[14] The Division subsequently sent EYLLP a subpoena for materials related to EYHM's engagement with Client B, such as client intake files and pre-engagement independence review. **(ENF 308)**. EYLLP provided those materials. **(ENF 309)**.

documents requested had actually been determined to be state secrets. Tr. 491:2-6. Nor has the Division ever received in the course of its investigation any documentation stating that any of the documents requested have been determined to be state secrets, or any other category of materials that are prohibited from production under Chinese law. Tr. 491:24-492:11.

Although in June 2012, the Division issued a Wells notice to EYHM **(ENF 141)**, EYHM still refused to provide its workpapers. Tr. 493:22-25. Because of EYHM's persistent violation of its production obligations, Division staff still "don't know really what's behind [EYHM]'s concerns and allegations regarding Client B." Tr: 492:21-22.

b. Client C

Client C, a Cayman Islands corporation with its primary operations in China, claims to provide enhanced recovery services for oil and gas exploration. *See* Exchange Act Rel. 67073 (5/30/12) **(ENF 51)**; Form 20-F (filed 3/31/11) **(ENF 50).** Client C's American Depository Shares were registered with the SEC, and traded on NASDAQ from November 2010 to October 2011. *See* Exchange Act Rel. 67073.[15] EYHM audited Client C's financial statements for the year ended September 30, 2010, issuing an unqualified audit opinion. *See* Form 20-F (3/31/11) **(ENF 50)**.

In August 2011, an Internet report surfaced, alleging, among other things, that Client C's importer and customers were shell companies with no significant business and that Client C's SEC filings were false and misleading. *See* Internet report **(ENF 53)**. In September 2011, EYHM issued a letter to Client C under Exchange Act Section 10A, reporting, among other things, that Client C's Chairman had engaged in unauthorized transactions resulting in the

[15] On May 30, 2012, the Commission revoked the registration of Client C's securities. Exchange Act Rel. No. 67073 **(ENF 51)**.

transfer of more than $40 million from Client C to another entity related to the Chairman. *See* Section 10A Letter **(ENF 54)**. Subsequently, EYHM withdrew its opinion with respect to Client C's financial statements for the year ended September 30, 2010 and resigned. *See* Form 6-K (filed 9/27/11) **(ENF 52)**.

In September 2011, the Division opened an investigation into potential accounting fraud at Client C, *see* Tr. 291:7-292:14 (David Peavler Testimony), focusing on two issues: (1) a possible overstatement by Client C of the value and number of its lateral hydraulic drilling units, the principal assets that the company used to generate revenue; and (2) Client C's Chairman's misappropriation of approximately $40 million of the company's cash. *See* Tr. 266:24-267:25. At the outset, the Division sent a voluntary request to EYHM for its workpapers relating to Client C. **(ENF 59)**; Tr. 273:14-25. The workpapers were "a critical piece of evidence to obtain [to] understand, for instance, what work had been done by the audit firm with respect to [the] financial statements [. . .], as well as what information had been provided to the audit firm by Client C, people with Client C, its officers and directors and other employees, and by third parties." Tr. 272:19-9. However, EYHM declined to produce its workpapers in response to the voluntary request, citing Chinese law restrictions. Tr. 274:24-275:21.

Accordingly, in February 2012, the Commission issued to EYHM a Section 106 demand for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client C] for the fiscal year ending September 30, 2010 and subsequent periods." *See* 106 Request to EYHM (2/2/12) **(ENF 55)**. EYHM refused to produce the documents, citing Chinese law impediments. R. Cohen Letter to D. Gordimer (4/4/12) **(ENF 56)**; Tr. 273:10-13. However, EYHM never indicated that it had consulted with Client C as to whether any of the requested documents contained state secrets, or that the firm had tried to get a determination that

any of the requested documents were state secrets. Tr. 278:11-14; Tr. 279:4-10. Further, the Division never received any documentation from the Chinese government during the course of its investigation indicating that the requested documents had been determined by the Chinese government to be state secrets or archives. Tr. 279:11-280:6.

On April 23, 2012, the Division filed a civil action against Client C, its chairman and CEO, and its former CFO. Tr. 280:20-25; Complaint **(ENF 57)**. However, without EYHM's workpapers, the Division was never able to assess possible misconduct by other company individuals or third parties. More significantly, the Division was unable to examine the quality, or even adequacy, of EYHM's audit work. Tr. 280:13-281:6.[16]

3. KPMG Huazhen

KPMG Huazhen played substantial roles in the preparation or furnishing of audit reports for Client D for the year ended December 31, 2010, *see* PCAOB Form 2 (filed 6/30/11) **(ENF 22)**, and Client F for the year ended December 31, 2009, *see* PCAOB Form 2 (filed 6/20/10) **(ENF 21)**, and performed audit work for Client E for the year ended December 31, 2010. KPMG Huazhen Answer ¶ 3.

a. Client D

Client D is a Delaware corporation with its primary operations in Xi'an, China. *See* Form 10-K (filed 3/16/11) **(ENF 62)**. Client D purports to engage in the wholesale distribution of finished oil and heavy oil products, the production and sale of biodiesel, and the operation of retail gas stations. *Id.* Client D's securities are registered with the SEC pursuant to Section

[16] For example, the Division quickly established during its investigation – by contacting a supplier of Client C located in Louisiana – that Client C had not purchased the volume of equipment from the supplier that it had claimed; but without the audit workpapers the Division could not assess whether EYHM had similarly undertaken to confirm the veracity of claims about key equipment obtained from suppliers. Tr. 281:12-283:4 (Peavler).

12(g) of the Exchange Act, *id.*, and were traded on NASDAQ from June 2009 until June 2011, *see* Client D Bloomberg Report **(ENF 63)**. KPMG Hong Kong audited Client D's financial statements for the year ended December 31, 2010, issuing an unqualified audit opinion. *See* Form 10-K (filed 3/16/11) **(ENF 62)**. KPMG Huazhen played a substantial role in that audit, as the "Subcontractor Assist Principal Auditor." *See* PCAOB Form 2 (filed 6/30/11) **(ENF 22)**.

In March 2011, a pair of Internet reports alleged, among other things, that Client D overstated both its revenue and its cash balance in its December 31, 2010 financial statements, that it failed to disclose multiple related-party transactions, and that it overstated the output of its main biodiesel fuel production facility. Tr. 739:1-740:12 (Leslie Kazon Testimony); Internet Reports **(ENF 64, 65)**. Shortly thereafter, the Division opened an investigation into potential accounting fraud at Client D. Tr. 740:10-12.

During its investigation, the Division sought documents from Client D and its auditors. Client D provided the Division with the requested documents and never asserted that the documents did (or might) contain state secrets. Tr. 740:13-23. In March 2011, the Division sent a voluntary document request to KPMG Hong Kong seeking workpapers and other documents related to its audit of Client D. **(ENF 297)**; Tr. 742:24-745:20. The Division expected that the workpapers could provide "a roadmap to the company's business" and "identify relevant witnesses" and "customers or third parties who [might] be in a position to confirm transactions." Tr. 743:9-23. KPMG Hong Kong refused to produce the workpapers because of "relevant PRC laws," including the certified public accountants law and the state secrets law. **(ENF 299)**; Tr. 746:4-747:7. Unsatisfied with the response not only because "it did not provide the workpapers," but also because it "didn't provide any kind of specificity about the grounds on which the documents sought were being withheld," Tr. 747:8-15, the Division sent a follow-up

letter to KPMG Hong Kong. **(ENF 301)**. In the letter, the Division sought clarification about the basis for KPMG Hong Kong's refusal to produce the requested workpapers. *Id.*, Tr. 747:25-749:16. In response, KPMG Hong Kong reiterated that the firm would not produce the workpapers, again citing to general provisions of Chinese law. **(ENF 303)**; Tr. 749:17-750:17.

In May 2011, in a further attempt to obtain audit workpapers, the Division sent a subpoena to KPMG, LLP (the U.S. affiliate of KPMG Huazhen). **(ENF 302)**. The subpoena sought documents, including workpapers, related to audit services provided to Client D by KPMG Hong Kong and KPMG Huazhen. *Id.*; Tr. 751:4-753:1. Although KPMG, LLP produced some documents in response to the subpoena, it did not produce any of the workpapers of KPMG Hong Kong or KPMG Huazhen. Tr. 753:2-753:10 (Kazon).

Unsuccessful in its previous attempts to obtain the audit workpapers, in February 2012, the Commission issued a demand to KPMG Huazhen for its audit workpapers under Section 106 seeking "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client D] for the fiscal year ending December 31, 2010." **(ENF 66)**; Tr. 754:14-754:19. Despite its mandatory production obligations, KPMG Huazhen again refused to produce its audit workpapers in response to the Section 106 request, citing Chinese law restrictions. **(ENF 67)**; Tr. 754:20-756:11. KPMG Huazhen, however, at no time indicated that any of the requested documents had been specifically designated as state secrets under Chinese law. Tr.757:2-7. Nor did the Division ever receive any documentation from the Chinese government indicating that the requested documents were, indeed, state secrets or archives under Chinese law. Tr. 758:12-759:4. Despite issuing a Wells notice to KPMG Huazhen in May 2012, **(ENF 137)**, the Division never received KPMG Huazhen's workpapers. Tr. 755:8-755:17.

b. Client E

Client E is a Nevada corporation with its primary operations in Ningbo, China. *See* Form 10-K (filed 4/13/12) **(ENF 70)**. Client E purports to manufacture and supply various petrochemical products in China. *Id.* Client E's securities are registered with the Commission pursuant to Section 12(g) of the Exchange Act, *id.*, and traded on NASDAQ from September 15, 2010 until October 7, 2011, *see* Client E Bloomberg Report **(ENF 72)**. On April 1, 2011, Client E disclosed that it would be unable to timely file its annual report on Form 10-K for the year ended December 31, 2010, because of "unexplained issues regarding certain cash transactions and recorded sales." *See* Form 8-K (filed 4/1/11) **(ENF 71)**. Client E's financial statements were audited by Patrizio & Zhao for the years ended 2008 and 2009, Tr. 187:13-20 (Fuad Rana Testimony); by KPMG Hong Kong from January until May 2011, Tr.176:4-7, Tr. 177:10-15; and by GHP Horwath for the year ended 2010, Tr. 187:21-25. Patrizio & Zhao conducted its audit of Client E with the assistance of individuals located in China. Tr. 190:15-21.

Shortly after Client E's disclosure, the Division opened an investigation into potential accounting fraud relating to Client E for the period 2008 through 2010. Tr. 168:3-168:10, 170:13-170:20, 170:25-171:18. In the course of its investigation, the Division sought documents from Client E and its auditors. Without asserting any Chinese law restrictions, Client E provided documents to the Division, including internal e-mails, financial records, and a copy of the company's general ledger. Tr. 174:14-23. Similarly, Patrizio & Zhao provided all of its audit workpapers. Tr. 187:11-188:1, 189:9-191:17; Patrizio & Zhao production letters **(ENF 321, 322, 323)**. Patrizio & Zhao raised no objections that the audit workpapers contained state secrets or archives under Chinese law. Tr. 190:22-191:4. Similarly, GHP Horwath produced a laptop containing all of its audit workpapers, Tr. 187:21-188:1, 191:18-192:14; GHP Horwath

production letter **(ENF 320)**, and never indicated that any of its audit workpapers contained state secrets or archives under Chinese law, Tr. 192:1-7. While Patrizio & Zhao's and GHP Horwath's workpapers were helpful, the Division still needed KPMG Huazhen's workpapers. Tr. 191:9-192:14.

In April 2011, the Division sent KPMG Huazhen a voluntary request for documents, including audit workpapers. **(ENF 287)**; Tr. 178:9-179:16. However, KPMG Huazhen refused to produce its workpapers in response to the voluntary request, citing Chinese law restrictions. **(ENF 289)**; Tr. 179:17–180:9. Dissatisfied with this response because "[i]t was extremely important [. . .] to get [KPMG Huazhen's] work papers and see what they had seen," Tr. 180:10-16; *see also* Tr. 192:15-193:3, the Division sent a follow-up letter to KPMG Huazhen. **(ENF 290)**, in which, among other things, the Division sought clarification regarding KPMG Huazhen's basis for refusing to produce the workpapers, *id.*; Tr. 180:21-181:19. In response, KPMG Huazhen reiterated its refusal to produce the workpapers, citing again to general provisions of Chinese law. **(ENF 292)**; Tr. 181:21 – 182:19.

Accordingly, in February 2012, the Commission sent to KPMG Huazhen a Section 106 demand for "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client E] for the fiscal year ending December 31, 2010." **(ENF 73)**; Tr. 194:3–194:14. KPMG Huazhen again refused to produce the documents, despite its statutory obligations. **(ENF 74)**; Tr. 194:21-196:10. Beyond its blanket assertion that all of the documents were state secrets, KPMG never made any "effort to delineate document by document or category of document by category of document," as to which ones might contain state secrets. Tr. 197:17-25. Nor did KPMG Huazhen ever indicate that it had consulted with Client E as to whether any of the requested documents contained state secrets. Tr. 198:1-7. Further, the

Division did not receive in the course of its investigation any documentation from the Chinese government indicating that the requested documents have been determined to be state secrets or archives under Chinese law. Tr: 198:8-23.

In May 2012, the Division issued a Wells notice to KPMG Huazhen. **(ENF 143)**. Despite the Wells notice, the Division never received the requested documents from KPMG Huazhen. Tr. 201:24-202:1. While able to file an action against Client E and its former CFO,[17] KPMG's refusal to produce its audit workpapers "frustrated" the Division's investigation and prevented the Division from being able to fully assess certain issues identified by KPMG Huazhen itself. Tr. 199:3-18, 200:14-201:14.

c. Client F

Client F, a Nevada corporation with its primary operations in Shanghai, China, *see* Form 10-K (filed 3/15/10) **(ENF 80)**, purportedly manufactures chemical additives used in the production of consumer and industrial products. *Id. See also* Tr. 785:20-786:5 (Roger Boudreau Testimony). Client F's securities were previously registered with the SEC pursuant to Section 12(b) of the Exchange Act, **(ENF 80),** and traded on NASDAQ from approximately May 2007 through June 2011, *see* Client F Bloomberg Report **(ENF 82)**; Tr. 786:22-787:11. KPMG Hong Kong audited Client F's financial statements for the years ended 2008 and 2009, issuing unqualified audit opinions. Tr. 790:5-23. KPMG Huazhen, played a substantial role with respect to Client F's audit report for the year ended December 31, 2009, PCAOB Form 2 (filed

[17] On February 28, 2013, the Commission brought a civil action against Client E and its former CFO charging each with violating or aiding and abetting violations of antifraud and other securities law provisions and alleging, among other things, that they failed to disclose properly certain related party and off-balance sheet transactions. *See* Complaint **(ENF 75)**, Lit. Rel. No. 22627 **(ENF 76)**; Tr. 199:19–200:13 (Rana). Also on February 28, 2013, the Commission, Client E, and Client E's former CFO filed a settlement with the court that, if approved, would enjoin Client E and Client E's former CFO from violating or aiding and abetting violations of antifraud and other securities law provisions and would require them to pay civil penalties. *Id.*

6/30/10) **(ENF 21)**, and performed audit work for Client F related to the years 2007-2010, *see* Tr. 787: 23-788:12, 790:5-791:6.

In March 2011, Client F disclosed that it was conducting an internal investigation into "potentially serious discrepancies" in its financial statements for the year ended December 31, 2010. *See* Form 8-K (filed 3/15/11) **(ENF 81)**. In April 2011, KPMG Hong Kong issued a letter to Client F under Exchange Act Section 10A, describing, among other things, "potentially serious discrepancies and/or unexplained issues relating to [Client F]'s financial records" *see* Section 10A letter (4/20/11) **(ENF 83)**, and resigned because of Client F's failure to take remedial action. *See* Form 8-K (filed May 5, 2011) **(RX 530)**.

During the same period, the Division began an investigation of Client F relating to, *inter alia*, revenue recognition practices and KPMG Huazhen's difficulty confirming both Client F's cash balances and customers. Tr. 788:13-22. Among other things, the Division sought documents from Client F and its auditors. Client F provided the Division with "thousands of pages of documents," Tr. 789:7-17, did not indicate that any of the documents contained state secrets, and did not withhold any documents on the basis of Chinese law, Tr: 789:18-790:4.

Similarly, the Division sent a voluntary request for documents, including audit workpapers, to KPMG Hong Kong. **(ENF 86)**; Tr. 791:7-13.[18] However, KPMG Hong Kong refused to provide its workpapers, citing Chinese law impediments. **(ENF 87)**; Tr. 793:23-794:11.

Because the Division had received no workpapers in response to its voluntary request, in February 2012, the Commission issued a mandatory request to KPMG Hong Kong and KPMG

[18] The Division staff approached KPMG Hong Kong rather than KPMG Huazhen because KPMG was Client F's principal auditor; at the time, Division staff was still not aware of KPMG Huazhen's substantial role in the audits of Client F. Tr. 791:14-793:22 (Boudreau).

Huazhen pursuant to Section 106 for "[a]ll audit work papers and all other documents related to any audit reports issued, audit work performed, or interim reviews conducted for [Client F] from January 1, 2008 to the present." **(ENF 84)**. However, KPMG Huazhen refused to produce its workpapers, instead citing again to general Chinese law restrictions. **(ENF 74)**; Tr. 797:10-15, 797:21-798:5. KPMG Huazhen never indicated that it had consulted with Client F as to whether any of the requested documents contained state secrets; nor did KPMG Huazhen indicate that the requested documents had actually been determined to be state secrets or archives under Chinese law. Tr. 798:6-19. The Division has received ***no*** documentation in the course of its investigation indicating that any of the documents have been definitively determined to be state secrets or archives. Tr. 798:20-799:6.

Consequently, in May 2012, the Division issued a Wells Notice to KPMG Huazhen. **(ENF 143)**. Despite the Wells Notice, KPMG Huazhen still failed to produce the requested documents. Tr. 797:13-20.[19]

4. DTTC and Client G

In addition to auditing DTTC Client A's financial statements, *see supra*, Facts Section IV.A, DTTC served as independent auditor for Client G from March 2, 2010 through September 6, 2010. *See* Forms 8-K (filed 3/3/10, 9/13/10) **(ENF 91, 92)**; DTTC Omnibus Answer ¶ 5. Client G is a Wyoming corporation with its primary operations in Beijing, China. *See* Form 10-K/A (filed 11/5/09) **(ENF 90)**. Client G purportedly designs, manufactures, and sells offset printing equipment. *Id.* Tr. 693:23-25 (Rhoda Chang Testimony). Client G's securities are registered with the Commission pursuant to Section 12(g) of the Exchange Act and traded on the NYSE from November 2009 through April 2011, after which they traded on the OTC market.

[19] KPMG Huazhen provided a single response to the Section 106 Requests relating to Client D, E, and F. *See* Aronow letter (3/27/12) **(ENF 67, 74, 85)**.

See Client G Bloomberg Report **(ENF 95)**. From July 1, 2009 through March 2010, Client G's financial statements were audited by the accounting firm Frazer Frost LLP. Tr. 694:20-23. A U.S.-based audit firm, Frazer Frost performed its audit of Client G by sending auditors to China to perform audit procedures. Tr. 699:25-700:4. On March 3, 2010, Client G engaged DTTC as its independent auditor. *See* Form 8-K (filed 3/3/10) **(ENF 91)**; Tr. 694:20-23.

In 2010, the Division commenced an investigation into Client G. The subject matter of the Division's investigation was related to matters reported in a Form 8-K filed by Client G on September 13, 2010. Tr. 695:2-9. **(ENF 92)**. Client G disclosed, among other things, that:

- Client G had terminated DTTC's engagement as independent auditor effective September 6, 2010;
- During the course of DTTC's audit of Client G for the fiscal year ended June 30, 2010, Client G had denied DTTC's request for permission to access original bank statements to verify the identity of certain individuals and entities;
- Several "reportable events," as defined in Item 304(a)(1)(v) of Regulation S-K, occurred during DTTC's audit of Client G; and
- Between September 6 and September 8, 2010, Client G's CEO, CFO, and several directors, including the Chair of its Audit Committee, all resigned their positions.

See Form 8-K (filed 9/13/10) **(ENF 92)**.

During its investigation, the Division sought documents from Client G and its auditors. Tr. 696:4-12. In response to a subpoena, Client G produced to the Division "a couple hundred thousand pages" of documents including "financial records, general ledges, invoices [and] purchase orders of Client G." Tr: 696:16-697:697. Client G made no assertions that any of the documents it provided to the Division contained state secrets. Tr. 697:2-5. Nor did Client G

withhold any documents from the Division based upon Chinese law restrictions. Tr. 697:6-9. The Division also sought documents, including audit workpapers, from Frazer Frost. Tr. 698:18-23. Frazer Frost produced to the Division all of the requested documents, withholding none based upon China state secrets or any other China law restrictions. Tr. 699:16-700:10.

Likewise, the Division sought DTTC audit workpapers relating to the work that DTTC performed for Client G. Tr. 700:11-16. DTTC audit workpapers were important to the Division's investigation into Client G because as the Division accountant assigned to the investigation testified:

> Well, in my, case, [DTTC] was in the field performing audit procedures. They have firsthand knowledge of all the issues that were identified in the Form 8-K. They interact[ed] with Client G's management. They were denied access of certain bank statements. So it is really important for me to review [DTTC]'s audit documentation to understand all the facts surrounding the issues and the potential accounting irregularities that they identified.

Tr. 701:1-10.

In addition to audit workpapers, the Division also requested from DTTC email communications as well as interviews and testimony from the audit staff that performed work for Client G. Tr. 701:13-15. The first step the Division took to obtain DTTC's audit workpapers was to reach out in October 2010 to [redacted] "a director with Deloitte Global Organization, Office of General Counsel, located in Chicago." Tr. 702:2-8.

[redacted] stated that he needed to reach out to DTTC, and then informed the staff that in order to produce workpapers to the Division, DTTC needed to get Client G's consent. Tr. 702:15-20. As a follow up, in May 2011, the Division sent a voluntary request for audit workpapers to DTTC. Tr. 704:11-14. Despite DTTC's receiving ***both*** a verbal consent from Client G and a written company resolution, DTTC did not produce its audit workpapers to the

staff, citing China secrecy laws. *See* **(ENF 84)**; **(ENF 95)**; Tr. 702:21-704:9. DTTC also denied the staff's request to interview its employees, also on state secrets grounds. Tr. 704:25-705:7.

Subsequently, the Division enlisted the assistance of the SEC's OIA to obtain DTTC's audit workpapers. Tr. 705:8-17. On June 30, 2011, OIA sent a request for assistance pursuant to the IOSCO MMOU to the CSRC seeking DTTC's audit workpapers with respect to Client G. **(ENF 211)**. The Division received no workpapers in response to that request. Tr. 706:1-6. In fact, the CSRC did not acknowledge the request. Tr. 979:4-15 (Arevalo).

Continuing in its efforts to obtain DTTC's Client G audit workpapers, in February 2012, the SEC served DTTC with a Section 106 request. **(ENF 93)**; Tr. 706:10-707:4 (Chang). The SEC sent the Section 106 request to DTTC "because the initial request [ ] sent to DTTC was a voluntary request. . . . [A] SOX 106 request is a mandatory demand that [DTTC] ha[d] to comply [with]." Tr. 706:13-707:4. Despite the mandatory nature of the Section 106 request, DTTC again refused to provide workpapers, citing China secrecy and other laws. Tr. 707:11-708:2. However, DTTC never indicated that any of the documents requested had been determined to be state secrets. Tr. 708:3-6. Nor did DTTC indicate that it had ever consulted with Client G as to whether any of the documents sought by the request contained state secrets. Tr. 708:7-11. Further, DTTC never indicated that the firm had tried to get a determination from the Chinese government as to whether any of the documents requested contained state secrets. Tr. 708:12-16. Nor has the Division ever received in the course of its investigation ***any*** documentation stating that any of the documents requested had been determined to be state secrets. Tr. 708:17-21. In April 2012, the Division issued a Wells notice to DTTC. **(ENF 144)**; Tr. 709:9-20. The Division still received no documents from DTTC after issuing the Wells notice. Tr. 709:21-24.

5. PwC Shanghai

PwC Shanghai was independent auditor, and performed audit work, for Client H between April 2010 and September 2011, and for Client I between December 2010 and December 2011. April 30 Order at 2 n. 5; PwC Shanghai Answer ¶ 5.

a. Client H

Client H is a Cayman Islands corporation with its primary operations in Shijiazhuang, China. *See* Form 20-F/A (filed 12/6/11) **(ENF 99)**. Client H purports to be China's largest commercial vehicle sales, servicing, leasing, and support network. *See* Form 6-K (filed 4/27/10) **(ENF 100)**. Client H's securities are registered with the SEC pursuant to Section 12(g) of the Exchange Act, *see* Form 20-F/A (filed 12/6/11) **(ENF 99)**, and traded on NASDAQ from October 2009 until October 2011, *see* Client H Bloomberg Report **(ENF 103)**. PwC Shanghai served as Client H's independent auditor from April 13, 2010 to September 16, 2011. *See* Form 6-K (filed 4/27/10) **(ENF 100)**; Form 6-K (filed 9/27/11) **(ENF 102)**.

In 2011, certain Internet reports alleged, among other things, that Client H overstated revenue and earnings by accounting for lease revenues upfront instead of recognizing this revenue over the duration of the leases; that there were discrepancies between Client H's cash flow and reported net income, as well as unreported executive compensation via stock earn-outs to the CEO; and that there existed other potential misrepresentations in Client H's public statements and Commission filings. *See* Internet reports **(ENF 104)**.

Subsequently, the Division opened an investigation looking into potential accounting fraud at Client H and potential market manipulation of Client H's securities. Tr. 855:11-855:17; 857:9-858:16 (David London Testimony). Among other things, the Division sought documents from Client H and its auditor. In response, Client H produced documents and information. Tr.

858:17-858:21. In addition, the SEC issued a mandatory Section 106 request to PwC Shanghai seeking "[a]ll audit work papers and all other documents related to any audit work or interim reviews performed for [Client H] for the fiscal year ending December 31, 2010." **(ENF 106)**. However, PwC Shanghai refused to comply with the Section 106 request, asserting that Section 106 did not apply to PwC Shanghai and that Chinese law prevented production of the requested documents. *See* Flynn letter to Kaleba (4/12/12) **(ENF 107)**; Tr. 870:24-871:17. PwC Shanghai never indicated that the firm had consulted with Client H as to whether any of the requested documents contained state secrets. Tr.872:6-11. Nor did PwC Shanghai ever indicate that specific documents sought by the Section 106 request had been determined to be state secrets. Tr. 871:25-872:5. Further, the Division never received during the course of its investigation any documentation from the Chinese government indicating that requested documents had been designated as state secrets or archives under Chinese law. Tr. 872:20-873:15.

In April 2012, the Division issued a Wells notice to PwC Shanghai. **(ENF 145)**. Despite issuing the Wells notice, the Division never received the workpapers. Tr. 870:13-23.

b. Client I

Client I, a Nevada corporation with its primary operations in Jinzhou, China, *see* Exchange Act Rel. 68249 (11/16/12) **(ENF 108)**, purportedly manufactures automotive electrical parts in China, *id.*; Tr. 363:19-364:6 (Stephen Kaiser Testimony). Client I's securities were previously registered with the Commission pursuant to Section 12(g) of the Exchange Act,[20] and traded on the NASDAQ Global Market from August 2007 through May 2011, *see* Exchange Act

[20] The registration of Client I's securities previously registered under Section 12 was revoked pursuant to an Order Instituting Proceedings, Making Findings, and Revoking Registration of Securities Pursuant to Section 12(j) of the Securities Exchange Act of 1934, issued on November 16, 2012. *See* Exchange Act Rel. 68249 **(ENF 108)**.

Rel. 68249 (11/16/12) **(ENF 108)**; Client I Bloomberg Report **(ENF 119)**; Tr. 364:7-24. Client I's financial statements were audited by PKF, Certified Public Accountants ("PKF") for the fiscal years ended December 31, 2008 and 2009. Tr. 369:18-21. PwC Shanghai was Client I's independent auditor from December 6, 2010 until December 6, 2011. *See* Form 8-K (filed 12/6/10) **(ENF 109)**; Form 8-K (filed 12/14/11) **(ENF 112)**.

In March 2011, Client I disclosed, among other things, that its financial statements for the years ended December 31, 2008 and 2009 and the financial statements included in each of its Quarterly Reports on Form 10-Q filed during 2008 and 2009, should no longer be relied upon and that Client I intended to engage PwC Shanghai to re-audit Client I's consolidated financial statements for those periods. *See* Form 8-K (filed 3/1/11) **(ENF 110)**. In October 2011, Client I disclosed the results of an internal investigation, which had concluded that certain transactions between an employee of a company acquired by Client I and a Client I 5% shareholder should have been disclosed, and that certain accounting errors existed in prior periods that might require restatement. *See* Form 8-K (filed 10/5/11 **(ENF 111)**.

The Division opened an investigation into Client I, covering the period 2007 until 2011, relating to "potential undisclosed related party transactions," "potential misappropriation of company assets" by insiders, "potential accounting irregularities," and "potential securities manipulation." Tr. 364:25-365:16. In the course of its investigation, the Division sought audit workpapers from Client I's auditors. Obtaining the audit workpapers was particularly important to the investigation, because of the difficulty the staff had encountered in obtaining documents from Client I. Tr. 392:24-393:14. PKF, which was based in Hong Kong, produced its audit workpapers to the Division voluntarily, withholding no documents based upon Chinese law restrictions. Tr. 374:7-24, 375:3-5.

The Division also made multiple attempts to get workpapers from PwC Shanghai, all of them unsuccessful. Initially, in September 2011, the Division sent PwC Shanghai a voluntary request for its workpapers related to certain aspects of Client I's purported business operations and financial results that were a focus of the Division's investigation. **(ENF 113)**; Tr. 376:18-377:18-378:14. PwC Shanghai, however, refused to produce any of the requested documents, citing Chinese law impediments. *See* Flynn Letter to Ramrattan (11/2/11) **(ENF 114)**; Tr. 378:15-379:25. Roughly two weeks later, the Division again requested that PwC Shanghai voluntarily produce certain categories of workpapers, correspondence, and other materials related to Client I. *See* Ramrattan Letter to Flynn (11/15/11) **(ENF 115)**; Tr. 380:13-382:10. Despite the Division's seeking a different set of documents in its second request, PwC Shanghai again refused to produce the requested documents. Flynn Letter to Ramrattan (12/2/11) **(ENF 116)**; Tr. 382:11-383:19.

Unsuccessful in its voluntary requests, in March 2012, the Commission issued a mandatory request to PwC Shanghai pursuant to SOX Section 106 for "[a]ll audit work papers and all other documents related to any audit work performed for [Client I] for the year ended December 31, 2010." **(ENF 117)**. Despite the request's mandatory nature, PwC Shanghai once again refused to produce the requested documents asserting that Section 106 did not apply to PwC Shanghai and in addition, that Chinese law restrictions prevented production. Flynn letter to Kaiser (4/12/12) **(ENF 118)**; Tr. 386:18-388:5. PwC Shanghai, however, never indicated that it had consulted with Client I as to whether the requested documents contained state secrets. Tr. 388:10-14. Nor did PwC Shanghai ever indicate that the requested documents actually had been determined to be state secrets. Tr. 388:6-9. Further, the Division has never received any documentation from the Chinese government in the course of its investigation indicating that the

requested documents actually had been determined to be state secrets or archive material under Chinese law. Tr. 391:22-392:17.

In April 2012, the Division issued a Wells notice to PwC Shanghai. **(ENF 146)**. Despite issuance of the Wells notice, the Division never received the audit workpapers. Tr. 387:1-5.

V. The Division Determined that Sending Additional Requests for Assistance to the CSRC Would Have Been Futile.

The Division concluded from its experiences in the DTTC Client A and Client G matters that making additional requests to the CSRC would be a waste of its time, as the CSRC had shown that it was simply not a viable gateway for obtaining assistance. *See infra*, Argument Section III.B.2. Accordingly, when consulted by other investigative teams, OIA advised that, while ultimately the team's choice, "it might not be worth their time and effort because of [OIA's] experience in obtaining – trying to obtain the audit work papers relevant to the investigation of Client A." Tr. 974:25-975:23, 976:6-22 (Arevalo).

In testimony, other Division staff explained their rationale for not seeking the assistance of the CSRC. *See* Tr. 182:23-183:14 (Rana):

> [W]e thought about making a request to the Chinese securities authority, the CSRC, to see if they might be able to help us obtain the audit work papers. And so we consulted with the SEC's OIA, Office of International Affairs, to see what their thoughts were on going that route.
>
> And through that consultation process, we became aware that another team looking at a China issuer had tried to seek assistance of the CSRC, and that process – I think it involved Deloitte – and that process sort of dragged out for a couple of years. And so based on their experience, we sort of concluded that seeking the assistance of the CSRC was not likely to yield any success. We weren't going to get documents out of that process, so we decided not to go that route.

See also Tr. 276:11-16 (Peavler) ("Ultimately in our discussions with the Office of International Affairs, we concluded as a group really that it would not be fruitful based on the prior experience

that OIA had had in trying to get audit work papers from China – from Chinese regulators."); Tr. 385:8-13 (Kaiser) ("It's my understanding that the Chinese regulators have not produced any documents or work papers pursuant to the Enforcement Division's previous requests in other cases. It was my understanding that we could expect not to receive any documents should we do so."); Tr. 623:9-19 (Weinstein) ("We had discussions relating to potentially going through OIA, our Office of International Affairs, to submit a request to the CRSC (sic). And the result of those discussions – as a result of those discussions, we determined that since we had been informed that there were other investigations in our posture that had submitted requests to the CSRC that were not fruitful and CRSC (sic) was not being responsive to those requests, that we would not submit a request through the CRSC (sic)."); Tr. 795:19-796:1 (Boudreau) (" . . . I also had an understanding that I believe through discussions with our Office of International Affairs that requests had been made in similar investigations to this, to try to obtain the work papers by contacting the Chinese authorities, and they had been unable to do it. They were able to make the requests. They were unable to obtain the work papers.").[21]

ARGUMENT

Rule 102(e)(iii) of the Commission's Rules of Practice provides that "[t]he Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found . . . [t]o have willfully violated . . .

[21] One investigative team made a request for assistance to the Hong Kong securities regulators for the audit work papers of KPMG HK relating to Client D. However, KPMG HK refused to provide the documents to Hong Kong securities regulators. *See* Tr. 753:14-23 (Kazon):

> A: [W]e made a request for assistance to the Hong Kong securities commission and – for audit work papers and related materials.
> Q: What was the result of that request?
> A: It was essentially a response from KPMG to the Hong Kong regulator to the effect that they would not produce the documents because of reasons of Chinese law, and I believe it also stated that all – most, if not all, of the documents were actually located in Mainland China.

any provision of the Federal securities laws or the rules and regulations thereunder." 17 C.F.R. 201.102(e)(iii).

Sarbanes-Oxley Section 106(b) states, in pertinent part:

> **(1) Production by foreign firms**
>
> If a foreign public accounting firm performs material services upon which a registered public accounting firm relies in the conduct of an audit or interim review, issues an audit report, performs audit work, or conducts interim reviews, the foreign public accounting firm shall—
>
> > (A) produce the audit work papers of the foreign public accounting firm and all other documents of the firm related to any such audit work or interim review to the Commission or the Board, upon request of the Commission or the Board . . . .

15 U.S.C. § 7216(b). Sarbanes-Oxley Section 106(e) provides that a foreign accounting firm's "willful refusal to comply, in whole or in part, with any request by the Commission or the Board under [Section 106], shall be deemed a violation of this Act." 15 U.S.C. § 7216(e). Such a willful refusal violates both Sarbanes-Oxley and the Exchange Act. *See* Sarbanes-Oxley Section 3(b), 15 U.S.C. § 7202(b)(1) ("A violation . . . of this Act . . . shall be treated for all purposes in the same manner as a violation of the Securities Exchange Act of 1934 . . . ."). Consequently, a foreign firm willfully violates the securities laws, and, therefore, may be censured or barred from appearing or practicing before the Commission under Rule 102(e), if the following circumstances occur:

1. One or more of the triggering conditions under Section 106(b)(1) is met – *i.e.*, a foreign firm [i] performs material services upon which a registered public accounting firm relies in the conduct of an audit or interim review, [ii] issues an audit report, [iii] performs audit work, or [iv] conducts interim reviews;

2. The Commission properly issues to the foreign firm a "request" for audit workpapers or other documents of the firm related to any such audit work or interim review; and
3. The foreign firm "willful[ly] refus[es] to comply, in whole or in part," with the request.

The first two prongs of a willful Section 106 violation, set forth above, are indisputably met for all of the Respondents in this case: Respondents are foreign firms that have satisfied at least one of the triggering conditions of Section 106(b)(1) for their respective China-based clients that are at issue in this proceeding. *See* April 30 Order, at 2 n.5; *id.* at 15 ("Respondents do not dispute that they were engaged to audit the financial statements of issuers of securities registered in the U.S., or in the case of KPMG Huazhen, provided some level of assistance to another firm in auditing financial statements, and that they performed certain audit work in the course of those engagements."); *supra* Facts Section IV; Division Prehearing Brief, at 29 (summarizing Respondents' audit work for Clients).[22]

In addition, each Respondent received from the SEC a valid Section 106 Request for audit workpapers and other documents related to audit work or interim reviews performed for their respective China-based clients for time periods in which they performed the work. *See supra*, Statement of Facts Section IV. The SEC properly issued these requests by delivering

[22] This is also true for engagements that did not result in a completed audit report. *See* First Prehearing Conference Tr. 13:22-25 (statement of PwC counsel) ("[T]here's no . . . . I think there's no dispute, Your Honor, that for PWC China that we did some audit work for Clients H and I."); Tr. 1547:17-20 (Leung) (EYHM did audit work for Client B); EYHM Powerpoint Presentation for Client B **(ENF 49)**; Tr. 1710:10-13 (George) (DTTC generated work papers with regard to the procedures it performed for Client G); Form 8-K filed by Client G (filed 9/13/10) (reflecting audit work by DTTC) **(ENF 92)**; Tr. 2227:4-16 (J.Wong) (KPMG performed "substantial role work" related to the audits of Clients E and F); Client F letter to SEC (4/20/11) (reflecting audit work by KPMG Huazhen) **(ENF 83)**.

them to the Respondents' respectively designated U.S. agents, and Respondents acknowledged receipt of these requests, demonstrating that they were aware of them. *See id.*

The third element of a willful Section 106 violation is also met in this case for all of the Respondents, because all of the Respondents willfully refused to comply with their respective Requests. "A finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law." *In the Matter of Peak Wealth Opportunities, LLC*, Exchange Act Rel. No. 69036, Admin. Proc. 3-14979, 2013 WL 812635, at *7 (ALJ Order Mar. 5, 2013) (citing *Wonsover*, 205 F.3d at 414; *Arthur Lipper Corp. v. SEC*, 547 F.2d 171, 180 (2d Cir. 1976)). An accounting firm's "failure to produce documents" requested by the PCAOB pursuant to Sarbanes-Oxley constitutes a "refusal" under the Act. *In re R.E. Bassie & Co.,* Accounting and Auditing Enforcement Act Release No. 3354, 2012 WL 90269, at *8 (Jan. 10, 2012). Thus, a foreign firm's knowing failure to produce documents in response to a Section 106 request constitutes a "willful refusal" under Section 106(e).

Under these standards, the record overwhelmingly demonstrates that Respondents willfully violated Sarbanes-Oxley and the Exchange Act, and, therefore, are subject to sanction. Most simply, they willfully refused to comply with the Requests by writing to the SEC and stating that they would not produce the requested documents. Respondents also willfully refused to comply with the Requests because, throughout the relevant time periods: (1) Respondents knew the Board or the SEC could require them to produce audit workpapers and other documents by issuing them requests under Section 106 (among other provisions); (2) Respondents knew that Chinese law could constrain their ability to comply with U.S. regulators' demands for information; (3) notwithstanding this knowledge, Respondents voluntarily accepted audit engagements with their respective Clients; (4) in connection with the Requests at issue,

Respondents decided to comply with the alleged constraints of Chinese law rather than with the Requests; and (5) Respondents, in fact, did not produce the requested documents.

Although Respondents claim that Chinese law prevented their compliance with the Requests, the constraints imposed by such law – whatever they may be – are legally irrelevant to the question of whether Respondents' conduct was "willful." That is because Respondents indisputably *knew* of the potential conflict of law *before* they accepted the engagements with the Clients. This prior knowledge wholly undermines any argument by Respondents that, now having performed audit work for the Clients and received the Requests from the SEC, their hands are tied. Respondents acted with "intent to do the act which constitutes a violation of the law," *id.*, and for that reason alone they are subject to an appropriate remedy under Rule 102(e).

I. A FOREIGN FIRM'S KNOWING FAILURE TO COMPLY WITH A SECTION 106 REQUEST CONSTITUTES A "WILLFUL REFUSAL" TO COMPLY

A. The Term "Willful" In Section 106(e) Should Be Given Its Ordinary Meaning Under The Securities Laws

1. "Willful" Is A Term of Art Used Throughout The Securities Laws

Use of the term "willful" in Section 106 is consistent with its use throughout the securities laws – including Rule 102(e) – to define violations by regulated persons and circumstances in which certain remedies should be imposed upon such persons. For example, the Exchange Act authorizes the SEC to suspend or revoke a broker-dealer's registration, and to impose civil penalties on the broker-dealer, for "willfully" making false or misleading statements in reports filed with the SEC, 15 U.S.C. §§ 78o(b)(4)(A), 78u-2, or for "willfully" violating, or aiding and abetting the violations of, any provisions of the Securities Act, Exchange Act, or certain other statutes or regulations, *id.* §§ 78o(b)(4)(A) (D), (E), 78u-2. The Exchange Act also authorizes analogous actions against municipal securities dealers and municipal advisors, *id.* § 78o-4(c)(2), government securities brokers and dealers, *id.* § 78o-5(c)(1)(A), and nationally

recognized statistical rating organizations, *id.* § 78o-7(d)(1); *see also id.* § 78u-2 (governing application of civil penalties for all these actions).[23] The Investment Company Act of 1940 authorizes analogous actions against persons serving investment companies, 15 U.S.C. § 80a-9(b), (d)(1), and the Advisors Act of 1940 prohibits "willful[]" untrue statements of material facts in registration applications or reports filed under that Act. 15 U.S.C. § 80b-7.

2. The Case Law Overwhelmingly Demonstrates That "Willful" Means Only Volitional Conduct In The Securities Law Context

For more than half a century, in interpreting these and other invocations of willfulness under the securities laws, federal courts and the Commission have consistently held that "willful" conduct is volitional conduct – *i.e.*, conduct about which the actor is mentally aware. In *Hughes v. SEC*, 174 F.2d 969 (D.C. Cir. 1949), the D.C. Circuit upheld the SEC's revocation of a broker-dealer's license under Exchange Act Section 15(b), for failing to disclose a security's best price to her clients, *see id.* at 974. "There [was] no room for doubt . . . that petitioner's violations were willful" where, "[p]rior to the institution of the present proceedings petitioner had been repeatedly advised by members of the Commission's staff that her methods of conducting her business were unlawful." *Id.* at 976. "Petitioner thus intentionally and deliberately chose to continue her methods of operation in spite of repeated advice that those methods were unlawful. *This was willfulness.*" *Id.* at 977 (emphasis added). The court further explained:

> It is only in very few criminal cases that 'willful' means 'done with a bad purpose.' *Generally, it means 'no more than that the person charged with the duty knows what he is doing. It does not mean that, in addition, he must suppose that he is breaking the law.'*

Id. (*quoting Dennis v. United States*, 171 F.2d 986, 990 (D.C. Cir. 1948)) (emphasis added).

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[23] In addition, the Exchange Act also provides that, where the Commission has barred a person from various professional associations as a result of misconduct, "[i]t shall be unlawful" for such person "without the consent of the Commission, willfully to become, or to be, associated with a broker or dealer in contravention of such order." Exchange Act § 15(b)(6)(B) [15 U.S.C. § 78o(b)(6)(B)].

More recently, in *Wonsover*, the D.C. Circuit upheld the SEC's suspension of a broker for "willfully violat[ing]" the securities laws under Exchange Act § 15(b)(4) [15 U.S.C. § 78o(b)(4)], by selling un-registered securities. *See* 205 F.3d at 412 n.10. The court confirmed that under its "traditional formulation of willfulness for the purpose of section 15(b)," *id.* at 415, "'willfully' . . . means intentionally committing the act which constitutes the violation"; it does not mean "that 'the actor [must] also be aware that he is violating one of the Rules or Acts,'" *id.* at 414 (quoting *Gearhart & Otis, Inc., Inc. v. SEC*, 348 F.2d 798, 803 (D.C. Cir. 1965) (quotations omitted)). Applying this traditional standard, the court in *Wonsover* rejected the broker's defense that he was unaware that relevant rules prohibited him from selling the securities at issue in the case.[24] Other courts have long, similarly interpreted "willfulness" to require a showing only that the violator acted intentionally, and not necessarily with knowledge that the conduct was prohibited. *See Mathis v. SEC*, 671 F.3d 210, 217-18 (2d Cir. 2012) (upholding broker's statutory disqualification from industry under Exchange Act § 3(a)(39)(F) [15 U.S.C. § 78c(a)(39)(F)), for "willfully" failing to disclose tax liens in his registration applications); *Arthur Lipper*, 547 F.2d at 181 n.7 ("[A] finding of actual knowledge is not necessary for finding criminal liability under § 24 of the Securities Act . . . for 'willful' violations of §§ 5(a) and (c) and 17(a)."); *Tager v. SEC*, 344 F.2d 5, 8 (2d Cir. 1965) (Securities Act § 24 prohibition against "willful violations" requires only intentional conduct, not knowledge that the conduct is prohibited).

"Willfulness" is routinely construed in a similar fashion in SEC administrative proceedings. "A person's actions are willful if he intentionally committed the act that constitutes

[24] The court in *Wonsover* also upheld the Commission's finding that Wonsover's violation was willful even under the subjective willfulness finding that the respondent had proposed. *Wonsover*, 205 F.3d at 415. This additional holding, however, does not affect the D.C. Circuit's affirmation of the "traditional formulation of willfulness" that it had applied under the Exchange Act at least since *Hughes.*

the violation or, if charged with a duty, he failed to meet his responsibility." *In the Matter of Application of Anthony Tricarico*, 51 SEC Docket 457, 1993 WL 183678, at *3 n.5 (May 24, 1993). Thus, registered persons who violated requirements that they produce or provide access to documents have been found to act willfully. In *Peak Wealth*, a disciplinary proceeding under Rule 102(e), this Court permanently barred one of the respondents, a certified public accountant registered with the PCAOB, from practicing before the Commission as an accountant. This sanction was based on, among other things, the respondent's willfully aiding and abetting an investment adviser's failure to comply with SEC examination staff's document requests as required under the Advisers Act. *Peak Wealth*, 2013 WL 812635, at *2, 5-8, 10. This ALJ stated, "[a] finding of willfulness does not require intent to violate the law, but merely intent to do the act which constitutes a violation of the law." *Id.* at *7.

And in *In re Dominick & Dominick, Inc.*, 50 S.E.C. 71, 1991 WL 294209 (May 29, 1991), the Commission found that Dominick, a broker-dealer registered with the SEC but based in Switzerland, willfully violated Exchange Act Rule 17a-4(j) by refusing to provide its books and records to SEC staff as required by the Rule. In rejecting Dominick's claim that Swiss secrecy laws prevented its compliance, the Commission stated:

> Broker-dealers registered with the Commission which operate under the strictures of the laws of multiple jurisdictions are required to be aware of the need to conduct their operations in a manner which will ensure compliance with the U.S. securities laws. At the time it opened its Basel branch office and began to conduct business in Switzerland, Dominick was aware of its record-keeping and production obligations under the U.S. securities laws. Dominick had an affirmative obligation to implement whatever special record-keeping procedures were necessary to avoid any possible conflict with Swiss law, including its secrecy provisions.

1991 WL 294209, at *6; *see also In the Matter of Amaroq Asset Management, LLC*, Initial Decision Release No. 351, 93 SEC Docket 2231, 2008 WL 2744866, at *10 (Jul. 14, 2008) (firm willfully violated Advisers Act § 204 by failing to submit to reasonable examination of its books

and records by SEC staff and failing to furnish copies of prescribed books and records to SEC in connection with scheduled examination).[25]

Finally, cases involving other types of government enforcement efforts, outside the securities context, confirm that "willfulness," like knowledge, is not contingent on any additional requirements, and may not be mitigated by excuses, however justifiable. *See Vineland Fireworks Co., Inc. v. Bureau of Alcohol, Tobacco, Firearms & Explosives*, 544 F.3d 509, 517 (3d Cir. 2008) (endorsing and applying government agency constructions of "willfulness" that "require knowledge of the conduct, but [ ] do not require a bad purpose or allow for a justifiable excuse."); *Harrington v. U.S.*, 504 F.2d 1306, 1316 (1st Cir. 1974) ("an act is 'willful' within the meaning of Section 6672 [of the Tax Code] if it is voluntary, conscious and intentional; no bad motive or intent to defraud the United States need be shown, and a 'reasonable cause' or 'justifiable excuse' element has no part in this definition.").

3. "Willful" Under Section 106(e) Means Only "Volitional"

The term "willful" in Section 106(e) should be given the same meaning that courts, the Commission, and ALJs have given it under numerous other securities law provisions, as described above. Interpreting "willful" to mean volitional conduct adheres to basic principles of statutory construction. The interpretive canon that repeated uses of specific words should be presumed to have the same meaning "has particular force where," as here, "the words at issue are

[25] DTTC's contention that, under the relevant statutory provision, the SEC could have obtained remedies against Dominick for either a mere failure to comply with Rule 17a-4(j) or a willful violation of that same rule (Prehearing Br. 19-20), is beside the point. In its decision, the Commission expressly stated that, notwithstanding any potential conflicts with Swiss law, "By delaying its production of the required books and records demanded, Dominick failed to satisfy its obligation to furnish promptly those books and records to the Commission upon demand. Accordingly, Dominick willfully violated Rule 17a-4(j)." *Dominick*, 1991 WL 294209, at *6; *see also id.* at *7 (finding that "Dominick has willfully violated Section 17(a)(1) of the Exchange Act and Rules 17a-3 and 17a-4 thereunder."). Thus, in *Dominick* the Commission made clear that a foreign entity's knowing failure to live up to its U.S. statutory obligations constitutes willful conduct irrespective of supposed domestic law constraints or potential alternative avenues of complying with U.S. production obligations.

used in two different sections of a complex statutory scheme and those two sections serve the same purpose." *Butler v. Social Security Admin.*, 331 F.3d 1368, 1372 (Fed. Cir. 2003) (internal quotation marks omitted) (quoting *National Organization of Veterans' Advocates, Inc. v. Secretary of Veterans' Affairs*, 260 F.3d 1365, 1379 (Fed. Cir. 2001)); *see also Gustafson v. Alloyd Company, Inc.*, 513 U.S. 561, 570 (1995) (term "prospectus" presumptively has same meaning in §12 of the Securities Act of 1933 as in §10 of the same statute); *Department of Revenue of Oregon v. ACF Industries, Inc.*, 510 U.S. 332, 342 (1994) ("identical words used in different parts of the same act are intended to have the same meaning.").

In addition, when Congress employs a term of art, "it presumably knows and adopts the cluster of ideas that were attached to each borrowed word in the body of learning from which it was taken." *Molzof v. United States*, 502 U.S. 301, 307 (1992) (quoting *Morissette v. United States*, 342 U.S. 246, 263 (1952)). When Congress enacted Section 106(e) in 2010, there was already a well-developed "cluster of ideas that were attached" to the term "willful," and so Congress should be presumed to have adopted it. This is especially true because the addition of Section 106(e) was an amendment to Sarbanes-Oxley. In the original 2002 Sarbanes-Oxley, Congress had adopted the Commission's use of "willful" by codifying Commission Rule 102(e) as part of the Exchange Act. Pub. L. 107-204, 116 Stat. 745 § 602 (2002); *see Altman v. SEC*, 666 F.3d 1322, 1326 (D.C. Cir. 2011) (the language of Exchange Act Section 4C, and thus of Sarbanes-Oxley 602, "is virtually identical" to Rule 102(e)). Section 106(e) and Rule 102(e) are part of the same statutory scheme, and, therefore, the term "willful" that appears in both provisions should be similarly construed.

B. "Refusal" Under Sarbanes-Oxley Means "Failure"

The word "refusal" as it is used in Section 106(e) means "failure." This meaning is consistent with how courts have interpreted "refusal" in other contexts. Interpreting a previous version of Federal Rule of Civil Procedure 37(a), the Supreme Court held in *Société Internationale* that the term "refusal" "clearly refers in several instances . . . to noncompliance *for any reason*." 357 U.S. at 207 n.1 (emphasis added). The Court further stated, "we think that a party 'refuses to obey' simply by *failing* to comply with an order." *Id.* at 208 (emphasis added).

Furthermore, as this ALJ correctly observed during the hearing, the Commission already has confirmed that "refusal" is correctly interpreted to mean "failure" in the context of document demands issued to accounting firms under Sarbanes-Oxley. Under Section 105(b)(3)(A) of Sarbanes-Oxley, the Board may take disciplinary action against a registered public accounting firm that "*refuses* to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation." 15 U.S.C. § 7215(b)(3)(A) (emphasis added). The Board has exercised its rulemaking authority to issue Board Rule 5110, titled "Noncooperation with Investigations," which codifies § 105(b)(3). *See id.* § 7215(a)(3)(A) (authorizing Board to establish rules for investigation and disciplining of firms). Rule 5110 states that, "[t]he Board may institute a disciplinary proceeding" against a public accounting firm or associated person that, among other things, "may have *failed* to comply with an accounting board demand" or "may otherwise have *failed* to cooperate in connection with an investigation." PCAOB Rule 5110(a)(1), (4) (emphases added). Thus, the Board clarified that for purposes of Section 105(b)(3), a firm's "refusal" to produce documents or otherwise cooperate with Board investigations is synonymous with its "failure" to do those things. The Commission approved

PCAOB Rule 5110 in 2004, stating that it, and companion Rules also approved at that time, "are consistent with the requirements of the Act and the securities laws and are necessary and appropriate in the public interest and for the protection of investors." Release No. 34-49704; File No. PCAOB-2003-07 (May 14, 2004). Through its approval, the Commission ratified the Board's equating the term "refusal" with "failure."

In addition, the Commission confirmed this definition in its decision in *In re R.E. Bassie & Co.*, Accounting and Auditing Enforcement Act Release No. 3354, 2012 WL 90269 (Jan. 10, 2012), stating that a registrant's "*failure* to produce documents in response to the [Board's demands] constitutes noncooperation for which the Board was authorized to impose sanctions," *id.* *8 (emphasis added). Although Bassie had not complied with the staff's document demand, he never expressly stated that he would not do so, and in fact repeatedly asserted that he did not intend to violate the law. Rather, Bassie and his counsel provided a series of rationales for his noncompliance – in particular, Bassie alternately claimed reliance on his counsel's advice that the Board's demand was unauthorized by statute and asserted that the burden of tax season rendered timely compliance effectively impossible. The Board rejected each of these excuses, holding, among other things, that Bassie's noncompliance constituted "refusal":

> The Board held that although Section 105(b)(3) is worded in terms of a "refus[al] to ... produce documents, or otherwise cooperate" with an investigation, the refusal need not be express: "To hold otherwise would render [S]ection 105(b)(3) a dead letter, since any noncooperating registered firm or associated person could then avoid [S]ection 105(b)(3) sanctions merely by refraining from expressly articulating a refusal to cooperate."

Bassie. at *6 (quoting Board decision). The Commission, exercising *de novo* review, affirmed this holding that Bassie had "refused" to comply with Board demands under Section 105 of Sarbanes-Oxley.

As *Bassie* makes clear, in Title I of the Act – which includes Sections 105 and 106 – "refusal" may include mere failure or omission to take a required action. Because Section 105(b)(3)(A) and Section 106(e) are situated within adjacent sections of a single Act and serve similar purposes, the shared term "refusal" should be interpreted to have the same meaning in both sections. *See Butler*, 331 F.3d at 1372; *supra*, Argument Section I.A.3. The fact that Congress enacted Section 106(e) in 2010, several years after the Commission approved PCAOB Rule 5110's definition of "refusal" as "failure," further supports construing "refusal" to mean "failure" under Section 106(e); Congress presumably knew and adopted this interpretation when it enacted Section 106(e). *See Molzof*, 502 U.S. at 307.

C. Neither The Language Nor The Structure of Sarbanes-Oxley Suggests That "Willful Refusal" Constitutes More Than Volitional Conduct

Disregarding decades of securities law precedent construing the term "willful" and the statutory scheme of Sarbanes-Oxley, Respondents contend that Section 106(e) requires the Division to show more than that Respondents knowingly failed to comply with the Requests. Respondents argue that the Division bears the burden of "prov[ing] that Respondents lacked good faith," DTTC Prehearing Br. 17, or, alternatively, that Respondents' "good-faith inability to comply with document demands due to foreign law" exonerates them from liability under Section 106(e), *id.* 24. Respondents are wrong on both counts. The Division does not need to show that Respondents lacked good faith (although the Division makes such a showing in any event, *see infra*, Argument Section II.B), nor does Section 106 incorporate a foreign-law defense to liability for failing to produce documents requested under that provision.

1. Section 106(e) Does Not Require A More Stringent Definition Of Willful

Respondents do not dispute that "willful" as traditionally used in the securities law context means "volitional." *See* DTTC Prehearing Br. 17. They nevertheless contend, relying on the canon of statutory interpretation that each term in a statute be given meaning, that by combining the words "willful" and "refusal" Congress intended to impose a higher scienter requirement on the Division. *Id.* 18. These arguments fail. The word "willful" comfortably modifies "refusal" without resort to the new, non-securities-law definition of the word urged by Respondents which, if applied here, would gravely undermine the statutory scheme.

Although Respondents cite to statutes using "paired modifiers" and related case law from the criminal context, DTTC Prehearing Br. 18-21, nothing in their discussion warrants a departure from the Division's definition of "willful refusal" as a "knowing failure." For one thing, the term "willful refusal" is not a paired modifier. It consists of a noun ("refusal") accompanied by an adjective ("willful"). Additionally, the very case law cited by Respondents wholly undermines their position. In *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47 (2007) (cited in DTTC Prehearing Br. 18) the Supreme Court construed the term "willfully fails," which appears in the civil liability provisions of the Fair Credit Reporting Act ("FRCA"). Recognizing that "'willfully' is a 'word of many meanings whose construction is often dependent on the context in which it appears,'" *id.* at 57, the Court rejected the heightened standard for "willfully" urged by the credit reporting companies, given the language and structure of the FRCA, *id.* at 59-60.[26] The companies had argued that the higher standard was required by the paired modifier "knowingly and willfully" set forth in FCRA's *criminal* enforcement provisions. *Id.* at 60. But

[26] Petitioners in *Safeco* unsuccessfully contended that "willfully failing" under the FCRA "goes only to acts known to violate the Act." 551 U.S. at 56-57.

the Court found that analysis from the "criminal side of the law" was "beside the point in construing the civil side," because in the latter "willfully" merely "giv[es] a plaintiff a choice of mental states to show in making a case for liability." *Id.*

Thus, *Safeco* disposes of Respondents' reliance on grammatical inferences from criminal case law, including *Arthur Andersen LLP v. United States*, 544 U.S. 696 (2005) (DTTC Prehearing Br. 20). *Arthur Andersen* is further distinguishable because the federal criminal statute at issue in the case (1) does not include the word "willful," and (2) *does* involve a paired modifier, *see id.* at 703 ("In this case, our attention is focused on what it means to 'knowingly . . . corruptly persuad[e]' another person . . . ."); *see also id.* at 706 (interpreting statute "to reach only those with the level of culpability we usually require in order to impose criminal liability" (internal quotation omitted)). *FPC v. Metropolitan Edison Co.*, 304 U.S. 375, 385-387 & n.3 (1938) (DTTC Prehearing Br. 20-21) also has no bearing on the issues here because (1) the pertinent discussion by the Court was dicta;[27] (2) the relevant statutory language analyzed by the Court governed criminal liability; and (3) the decision preceded the decades of judicial precedents uniformly interpreting "willfully" to mean "volitionally" in the civil securities law context.

Finally, even assuming the word "refusal" must be construed to include a volitional component (which it need not be), any resulting overlap in the meanings of "willful" and "refusal" still would not defeat the Division's interpretation of "willful refusal." "[A] provision

[27] In *Metro Edison Co.*, 304 U.S. 375, the Court held that the federal court of appeals did not have jurisdiction to hear the claims of petitioners seeking to halt administrative proceedings brought against them by the Federal Power Commission. In so holding, the Court observed that, in the event that the Commission sought to enforce its directions to the companies to appear, testify, or produce books and records, it could do so by applying to a federal court for an order compelling the companies; that the court could then levy *criminal sanctions* against "[a]ny person who willfully shall fail or refuse to attend and testify or to answer any lawful inquiry or to produce books, papers, correspondence, memoranda, contracts, agreements, or other records, if in his or its power to do so, in obedience to the subpoena of the Commission." *Id.* at 386 n.3.

that may at first glance appear to be textual surplusage, may in fact 'perform[] a significant function simply by clarifying.'" *Public Citizen, Inc. v. Rubber Manufacturers Ass'n*, 533 F.3d 810, 818 (D.C. Cir. 2008) (quoting *United States v. Atlantic Research Corp.*, 551 U.S. 128 (2007)). In this scenario, the word "willful" still would perform an important clarifying function; it would make clear that a foreign firm's refusal to comply with a Section 106 request must be volitional in the same sense that all other "willful" conduct must be volitional for civil liability to attach under the securities laws. Furthermore, the rule against surplusage does not automatically trump other canons of statutory construction.

> As the Supreme Court has cautioned, "our preference for avoiding surplusage constructions is not absolute." *Lamie v. United States Tr.*, 540 U.S. 526, 536 (2004). While a court should, "'if possible,' ... construe a statute so as to give effect to 'every clause and word,' .... [n]o canon of construction justifies construing the actual statutory language beyond what the terms can reasonably bear." *Amoco Prod. Co. v. Watson*, 410 F.3d 722, 733-34 (D.C. Cir. 2005) (quoting *United States v. Menasche*, 348 U.S. 528, 538-39 (1955)).

Public Citizen, 533 F.3d at 816. Here, a construction that adopts a heightened meaning of "willful" – particularly one that requires the *Division* to prove that Respondents lacked good faith – would be far more than what the terms of Sarbanes-Oxley "can reasonably bar." First, it would run afoul of competing interpretive canons that (1) a term used throughout a statute or statutory scheme should be interpreted consistently, and (2) Congress is presumed to have adopted a pre-existing "cluster of ideas" that attaches to a statutory term. *See supra*, Argument Section I.A.3.

Second, Respondents' construction produces an absurd result. Under Respondents' construction, foreign firms might evade their U.S. statutory obligations merely by raising the specter of potential conflicts of law, thereby requiring the SEC to prove the *absence* of a foreign law constraint. This cannot be the law. Respondents provide no authority for this extreme

proposition, or for the notion that in a non-criminal context, in the absence of any clear textual requirement, the government bears the burden of showing bad faith. As discussed below, Respondents here exhibited lack of good faith regardless of the content of Chinese law, *infra*, Argument Section II.B; other cases, however, conceivably could present different factual scenarios, and in no event could Sarbanes-Oxley reasonably be construed to require the SEC to make an affirmative case regarding foreign law. Respondents' construction violates the "elementary rule of construction that 'the act cannot be held to destroy itself.'" *Citizens Bank of Maryland v. Strumpf*, 516 U.S. 16, 20 (U.S. 1995) (quoting *Texas & Pacific R. Co. v. Abilene Cotton Oil Co.*, 204 U.S. 426, 446 (1907)).

2. The Doctrine Of Prescriptive Comity Is Irrelevant To The Proper Construction Of Willful Refusal

The doctrine of prescriptive comity has no bearing on the proper interpretation of Section 106(e). Respondents contend that prescriptive comity requires that "any statutory ambiguity must be resolved in a way that 'avoid[s] unreasonable interference with the sovereign authority of other nations.'" DTTC Pre-Hearing Brief at 21 (quoting *F. Hoffman-La Roche Ltd. v. Empagran, S.A.*, 542 U.S. 155, 164 (2004)). But regardless of how "willful refusal" is interpreted, these proceedings do not seek to compel Respondents to produce documents to the Commission, and no interference with foreign law – much less "unreasonable" interference – can result. *See* April 30 Order, at 7 ("[t]he Division is plainly not seeking to enforce the requests or obtain documents through these proceedings . . . .").

None of the remedies sought by the Division even arguably implicates any foreign laws identified by Respondents. The Proposed Bar implicates only the Respondents' prerogatives *within the United States*; it does not threaten to offend the decision-making authority of any foreign sovereign. And Respondents do not even attempt to argue that censure would have any

consequences for China's sovereign interests. Nor do Respondents offer any explanation as to how the Division's interpretation of "willful refusal" in itself could constitute an affront to foreign nations. Section 106(e) defines the conduct that constitutes a violation of U.S. securities laws, but provides no mechanism for compelling any action from foreign public accounting firms, including action that could violate foreign laws.

Courts have made clear that in such circumstances, comity concerns are not implicated. As stated by the Third Circuit, "Comity is essentially a version of the golden rule: a 'concept of doing to others as you would have them do to you. . . .' Thus, it may be permissible to prescribe and enforce rules of law in a foreign country, but unreasonable to do so in a particular manner because of the intrusiveness of a particular type of sanction." *Republic of Philippines v. Westinghouse Elec. Corp.*, 43 F.3d 65, 75 (3d Cir. 1994) (citations omitted). Here, the Division argues for an interpretation of U.S. law that would make no intrusion whatsoever into a foreign country; the Division's interpretation of "willful refusal," and the related remedies sought, would affect the foreign firms' participation in *U.S.* markets. Respondents' cited case law reinforces this point. In *Empagran,* the Supreme Court held that comity concerns weighed against a statutory interpretation that would allow parties to seek redress under U.S. antitrust law for *foreign* harms caused by foreign anticompetitive conduct. The Court made clear, however, that "application of our antitrust laws to foreign anticompetitive conduct is nonetheless reasonable, and hence consistent with principles of prescriptive comity, insofar as they reflect a legislative effort to redress *domestic antitrust injury that foreign anticompetitive conduct has caused.*" 542 U.S. at 165 (emphasis added). In other words, prescriptive comity allows U.S. law to reach even foreign conduct to the extent the consequences of that conduct are felt in the U.S. In this proceeding, the Division seeks to remedy Respondents' conduct in U.S. markets. Under

Empagran, then, prescriptive comity poses no obstacle to the Division's proposed interpretation of Section 106(e).

3. Section 106(e) Does Not Incorporate A Foreign-Law Defense

Respondents further contend that, even if the Division's interpretation of the "willful refusal" standard is correct, Respondents nonetheless cannot be liable under Section 106(e) because "it is well-settled that the good-faith inability to comply with document demands due to foreign law precludes sanction in U.S. court." DTTC Prehearing Br. 24. Respondents are again wrong in multiple respects. As an initial matter, whatever the foreign law constraints Respondents contend they are under, Respondents cannot demonstrate "good-faith inability to comply." To the contrary, they have been fully aware of the potential impediments of Chinese law since they registered with the Board and accepted U.S. audit engagements. *See infra*, Argument Section II.A. In any event, the term "willful refusal" in Section 106(e) does not permit any defense based on a good-faith inability to comply, nor can foreign law constitute a "justifiable excuse" under the provision. Willfulness means "no more than that the person charged with the duty knows what he is doing." *Hughes*, 174 F.2d at 977 (internal quotation omitted); *see also Tricarico*, 1993 WL 183678, at *2 n.5 ("A person's actions are willful . . . [where], if charged with a duty, he failed to meet his responsibility"). So long as Respondents were cognizant of their refusals to comply with the Requests, which they undoubtedly were, it matters not at all whether the reason for their refusal was their desire to avoid sanctions under foreign law. Respondents' argument is just another ill-fated attempt to challenge the traditional securities-law understanding of willfulness as volitional conduct.

Respondents again try to support their argument by citing to criminal law propositions but, as explained above, it is well-established that "willfulness" can carry a different meaning

under the criminal law. *See Bryan v. United States*, 524 U.S. 184, 191 (1998) (cited in DTTC Prehearing Br. 25) ("As a general matter, *when used in the criminal context*, a 'willful' act is one undertaken with a 'bad purpose.'" (emphasis added)). Respondents' citations to cases in which courts declined to impose certain sanctions for failures to produce documents in civil litigation (DTTC Prehearing Br. 24) are also unavailing. None of those cases, including *Société Internationale*, involved an application of the securities-law meaning of the word "willfulness." Additionally, these cases did not involve, as this one does, application of a specialized statutory scheme (Sarbanes-Oxley) that authorizes a U.S. agency (the SEC) to take remedial action against regulated entities that voluntary participate in U.S. markets but, for whatever reason, do not follow U.S. rules.[28] Respondents' argument for a foreign-law exception to Rule 106(e) should be rejected, as there is no valid justification in law or policy for such an exception.

D. Strong Policy Interests Support The Conclusion That A "Willful Refusal" Means A "Knowing Failure" To Comply

The Commission's need to "protect the integrity of its own processes" through these proceedings, *Touche Ross & Co. v. SEC*, 609 F.2d 570, 581 (2d Cir. 1979) (construing predecessor Rule 2(e)), further supports the conclusion that "willful refusal" under Section 106(e) means "knowing failure." "The purpose of Commission Rule 102(e)(1)(iii) is remedial and the rule is directed at protecting the integrity of the Commission's own processes and the

[28] Even assuming case law addressing sanctions for failure to comply with document requests outside the Section 106 context were relevant, the weight of authority supports the imposition of such sanction on parties, such as Respondents here, who voluntarily enter U.S. markets (or otherwise subject themselves to U.S. jurisdiction) and later claim an inability to comply with U.S. rules because of foreign law. *See, e.g.*, *Richmark Corp. v. Timber Falling Consultants*, 959 F.2d 1468 (9th Cir. 1992) (upholding sanction against Chinese company for failing to produce documents notwithstanding directions of Chinese government); *United States v. Bank of Nova Scotia*, 691 F.2d 1384 (11th Cir. 1982) (upholding contempt finding for failure to produce notwithstanding prohibitions of Cayman Islands law); *United States v. Vetco, Inc.*, 691 F.2d 1281 (9th Cir. 1981) (upholding sanctions for a corporation's refusal to comply with IRS summonses despite possible criminal liability under Swiss law); *Gucci Am. v. Weixing Li*, No. 10cv4974 (RJS), 2012 WL 5992142 (S.D.N.Y. Nov. 15, 2012) (holding Bank of China in civil contempt and ordering daily fine).

confidence of the investing public in the integrity of the financial reporting process." April 30, 3013 Order, at 7 (citations and quotations omitted). Courts have recognized that SEC oversight of auditors is particularly essential given their central role in our disclosure-based securities markets: "To insulate from disclosure a certified public accountant's interpretations of the client's financial statements would be to ignore the significance of the accountant's role as a disinterested analyst charged with public obligations." *United States v. Arthur Young & Co.*, 465 U.S. 805, 818 (1984). *See also Marrie v. S.E.C.*, 374 F.3d 1196, 1200-1201 (D.C. Cir. 2004) (SEC's disciplinary authority under Rule 102(e)(1)(iii) is an acknowledgement of "the particularly important role played by accountants in preparing and certifying the accuracy of financial statements of public companies that are so heavily relied upon by the public in making investment decisions").

As this ALJ recognized, and as demonstrated throughout these proceedings, audit workpapers play a critical role in the SEC's oversight and regulation of securities markets:

> [A]ccess to audit work papers allows the Commission to determine whether an auditor has complied with the standards of conduct set forth in Exchange Act Section 10A, address fraud that may preclude or delay the filing of an audit report, and assist the Commission in determining the accuracy of previous audit reports prepared by the issuer.

April 30 Order at 15. *See also* Consolidated Opp. at 27-30; Stuart and Wright, 2002 COLUM. BUS. L. REV. 749, 755 ("Comprehensive SEC investigations require access to [ ] foreign audit workpapers."); *infra*, Argument Section III.B.3.

Thus, application of the "traditional" test for willfulness to Section 106(e) is not only supported by decades of case law and principles of statutory construction, as set forth above, *supra*, Argument Section I.A.2; it makes sense in light of the purpose of Rule 102(e) proceedings generally. The Division seeks to remedy an obviously untenable situation, of Respondents' own making, that seriously weakens Commission processes to the detriment of U.S. investors.

Respondents have accepted engagements of U.S. issuers fully anticipating that, when called upon by U.S. regulators to provide cooperation that is essential to the SEC's oversight of U.S. markets, they will not do so. Rather, without any statutory basis, Respondents seek to shift to the SEC the burden of trying to negotiate with foreign regulators to obtain the necessary documents, regardless of whether those regulators will ever agree to help the SEC. Thus, Respondents would arrogate to themselves a special status, by denying the SEC the type of cooperation that domestic accounting firms routinely provide under other statutory mechanisms. Moreover, in Respondents' view, they can *continue* the status quo indefinitely: they can continue to flout U.S. production requirements, claiming no more than risk of sanction under Chinese law, without fear of any consequence under Rule 102(e) and Section 106(e).

There is no valid reason to construe "willful" in Section 106(e) to produce such a harmful result. "Willful" should be given its traditional meaning under the securities laws and applied here to recognize that Respondents have willfully violated Sarbanes-Oxley. Thus, the Commission can properly realize its authority to protect its processes under Rule 102(e).

II. RESPONDENTS WILLFULLY REFUSED TO COMPLY WITH THE REQUESTS

The record conclusively demonstrates that all of the Respondents willfully refused to comply with the Requests under Section 106. This is true regardless of whether the term "willful refusal" means "knowing failure," as the Division has urged, or includes a requirement that the Division show that Respondents acted with a lack of good faith. In addition, assuming, *arguendo*, the law can be construed to permit Respondents to assert an affirmative defense that they had a "good faith inability to comply with document demands due to foreign law" or acted with a "justifiable excuse," DTTC Prehearing Br. 25-26, such defenses fail on the facts.

A. Respondents Knowingly Entered United States Markets And Failed To Produce Documents To The SEC Upon Request

There can be little doubt that, under the traditional construction of "willful" that applies to Section 106(e), Respondents violated Sarbanes-Oxley by willfully refusing to comply with the Requests. All of the Respondents "kn[e]w what [they were] doing" when they registered with the Board and accepted audit engagements of U.S. issuers, *Hughes*, 174 F.2d at 977; thus, they "intentionally commit[ed] the act which constitutes the violation," *Wonsover*, 205 F.3d at 414. Respondents were fully aware that they were required to register with the Board to audit U.S. issuers, Tr. 1327:15-1327:18 (Chao); 1655:7-1655:11 (George); 1938:21-1939:19 (Isaac Yan Testimony); 2103:3-2103:7 (Ji Feng Testimony); 2229:24-2230:4 (J. Wong), and that when they registered with the Board they could be required to comply with production demands of U.S. regulators – including Section 106 requests by the SEC – for their audit work related to U.S. issuers. Tr. 1661:23-1662:7 (George). *See supra*, Statement of Facts Section II.

At the same time, Respondents also indisputably knew that Chinese law potentially could impair their ability to comply with these demands. *See* Tr. 1331:20-1334:3 (Chao); 1499:6-1504:8 (Leung); 1656:1-1658:14 (George); 2101:21-2102:21 (Feng). First, Respondents acknowledged this in their registration forms. Indeed, each Respondent in its Form 1 filed with the Board declined in response to Item 8.1 to provide a consent "to cooperate in and comply with any request for testimony or the production of documents made by the Public Company Accounting Oversight Board in furtherance of its authority and responsibilities under the Sarbanes-Oxley Act of 2002." *See supra*, Statement of Facts Section II. Instead, Respondents attached legal opinions as to why they could not provide such consents. *See supra*, Statement of Facts Section II n.4 and accompanying text.

Second, Respondents acknowledged during the hearing that, in fact, they knew at the time of their registrations that PRC legal impediments could prevent their compliance with their production obligations under U.S. law. *See* Tr. 1329:2-1334:3 (Chao); 1655:12-1661:22 (George). According to the testimony of Raymond Chao of PwC Shanghai:

> Q: [ ] Mr. Chao, you'll agree with me that, in 2004, PwC Shanghai understood that PRC law could potentially prohibit your firm from cooperating with any requests from the United States, correct?
> A: Correct.
> Q: And your firm understood that, if you violated PRC law, you could potentially face very severe sanctions, correct?
> A: Correct.

Tr.1333:20-1334:3.

Third, Respondents' own Chinese law expert confirmed that by the time of Respondents' registrations with the Board, China's concerns about protecting state secrets were well established and that "when the Respondents registered with the PCAOB in 2004, they had to know that they might not be able to produce their audit work papers to U.S. regulators because of state secrets concerns." Tr. 2563:13-2563:19 (James Feinerman Testimony).

Thus, Respondents pursued registration with the Board, gaining all its attendant privileges, despite knowing full well that Chinese law might prevent them from meeting their legal responsibilities. Respondents now attempt to disclaim their willfulness by asserting, *inter alia*, that the Board is to blame for permitting them to register, *see* Tr. 1335:18-1337:16 (Chao); 2104:15-2107:7 (Feng), but the Board made it abundantly clear in its response to each Respondent's registration application that: "[The firm's] failure to supply a 'Consent to Cooperate with the Board' (Item 8.1 of Form 1) does not relieve [the firm] of the obligation to cooperate in and comply with Board demands (including for documents or testimony) and to enforce cooperation and compliance by [the firm's] associated persons." *See,* Letter from

PCAOB to each Respondent **(ENF 6 – ENF 10)**. And Respondents understood that the Board's position was that their assertions of legal conflicts did not relieve them of their obligations to provide documents and testimony to the Board upon request, as reflected in the testimony of Richard George, of DTTC: (George) (DTTC):

> Q: And your firm understood that, regardless of the Century-Link law firm opinion, the PCAOB at least was telling you, you were not relieved of your obligation to comply with Board demands, right?
> A: Right.
> Q: And you understood that in 2004?
> A: Yes.
> Q: And your firm understood that?
> A: We did understand that.

Tr. 1664:19-1665:3. *See also* Tr. 1506:16-1506:20 (Leung); 2107:9-2107:18 (Feng).

Further, the Board informed Respondents that performing certain work for U.S. issuers implicates these cooperation and production obligations: "If [the firm] prepares or issues, or plays a substantial role in preparing or issuing, an audit report with respect to any issuer (as 'issuer' is defined in the Sarbanes-Oxley Act of 2002), U.S. law and the Board's rules impose cooperation and compliance requirements that apply to [the firm] despite the absence of a consent under Item 8.1." *See,* Letter from PCAOB to each Respondent **(ENF 6 - ENF 10)**.[29]

Despite acknowledging acceptance and understanding of the Board's warning, Tr. 1336:19-1337:7 (Chao); 1506:16-1506:20 (Leung); 1667:1-16689 (George), Respondents did not renounce their registrations with the Board, nor did Respondents decline engagements for U.S.

[29] Respondents further disclaim their willfulness by now contending that they believed the SEC and Chinese regulators would eventually work out a solution to the production of audit work papers. *See*, Tr. 1506:9-1506:12 (Leung) ("We understood the PCAOB's position but we expect [sic] that there would be a solution among or between the governments and indeed a solution has come down."). Rather than refuting their willfulness, Respondents' optimism about the future regulatory landscape only underscores that, when they registered with the PCAOB and took on U.S. audit engagements, they knew they could not comply with production obligations.

issuers.[30] In fact, Respondents chose willingly to undertake audit work for U.S. issuers, even increasing their number of U.S. issuer audit clients over time, and earning substantial fees for this work. Tr. 1669:7-1674:4 (George); 2239:13-2245:12 (J. Wong).

Furthermore, after the 2010 Dodd-Frank Act, Respondents confirmed their understanding of the new and expanded production requirements under the amended Section 106, by designating U.S. agents for receipt of document demands and related service of process. *See supra*, Statement of Facts Section II. As this ALJ noted:

> The Commission's authority to discipline accountants pursuant to Commission Rule 102(e) is well established, and Respondents have been on notice since the passage of [Dodd-Frank] in July 2010 that a willful refusal to comply with a Commission request pursuant to Section 106 would constitute a violation of Sarbanes-Oxley.

April 30 Order, at 10. Nowhere in their designations for receipt of document demands, filed with the Commission, did Respondents indicate that while willing to comply with the requirement to designate an agent, Respondents were unwilling or unable to comply with any actual document demands.[31]

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[30] Regardless of the reservations Respondents believed they had claimed for themselves by omitting Consents to Cooperate from their registration Form 1s, those purported reservations were directed only to the Board. Nothing in Respondents' application papers addressed their obligations in response to direct production demands from the SEC, either by way of Section 106 requests or any other process.

[31] Section 106(d) designations, *filed with the Commission*, are different from those designations, *not filed with the Commission*, made pursuant to Section 106(b)(2)(B). Under Section 106(b)(2)(B), "any registered public accounting firm that relies, in whole or in part, on the work of a foreign public accounting firm in issuing an audit report, performing audit work, or conducting an interim review, shall secure the agreement of any foreign public accounting firm to such production [of audit work papers], as a condition of reliance by the registered public accounting firm on the work of that foreign public accounting firm." In contrast to their Section 106(d) designations filed with the Commission, in which Respondents made no reservations about consenting to the designation of an agent, in designations pursuant to Section 106(b) provided to their affiliates, Respondents consented to produce work papers only "to the extent permitted by the applicable law of the Peoples' Republic of China and any other laws which may be applicable to the place where any relevant work papers were created." *See, e.g.* Section 106(b) Designations by Respondents **(RX 4, 369, and 515).**

Nor did Respondents scale back their U.S.-focused business activities. To the contrary, they maintained their Board registrations and obtained even more audit engagements with U.S. issuers. *See supra*, Statement of Facts Section III. As Respondents admitted in testimony, they each in 2010, 2011, and 2012 performed audits or substantial role work for audits of issuers knowing that, if called upon by U.S. regulators to produce workpapers associated with those audits, Chinese law might constrain their ability to do so. Tr. 1339:3-1342:12 (Chao); 1506:25-1513:14 (Leung); 1668:10-1677:3 (George); 2239:13-2244:21 (J. Wong).

Yet despite knowing their production obligations under Section 106 (and other U.S. law requirements) and voluntarily engaging in U.S.-focused business, Respondents refused to comply with the Requests at issue in these proceedings. "This was willfulness." *Hughes*, 174 F.2d at 977. The SEC initiated 10 different investigations into potential fraud at the Clients whose securities were registered with the SEC and traded in U.S. markets. *See supra*, Statement of Facts Section IV. It is very likely that the frauds that occurred victimized U.S. investors.[32] For each such investigation, the SEC sent a Request to the Respondent that had performed audit work for the Client, seeking audit workpapers and related documents. In each case, the Respondent refused to produce to documents in response to the Request. Each refusal was itself knowing (and not inadvertent or otherwise unintentional), as demonstrated by the fact that in each instance the Respondent stated its refusal in writing. *Cf. Paz Secs., Inc. v. SEC*, 494 F.3d 1059, 1063 (D.C. Cir. 2007) (Commission found that respondent "actually knew about the requests for information" and therefore "failure to respond was [not] unintentional").

[32] As a result of its investigation involving Client C, the SEC brought suit in federal district court against the entity and related individuals and subsequently settled the charges. *See* Civil Action Complaint against Client C, et al. **(ENF 57);** Settlements in Civil Action against Client C, et al. **(ENF 61)**. As a result of its investigation involving Client E, the SEC filed settled charges in district court against the entity and a related individual. *See* Civil Action Complaint against Client E, et al. **(ENF 75)**. The SEC is continuing to litigate the charges it brought against the entity and related individuals as a result of its investigation involving Client H. *See* Civil Action Complaint against Client H, et al. **(ENF 105)**.

Although Respondents contend that they were prohibited by Chinese law or regulators' instructions from producing documents to the SEC in response to the Requests, this is of no consequence to the willfulness inquiry here. When Respondents voluntarily availed themselves of U.S. markets – and profited thereby – they were responsible for ensuring their ability to comply with U.S. securities laws. Where they took on engagements that might later present conflicts of law, they did so at their own peril. *See Dominick*, 1991 WL 294209, at *6 n.15 (rejecting broker-dealer's attempt to rely on foreign law to "invalidate [its] pre-existing statutory obligation" to produce documents; "where an entity voluntarily elected to do business in numerous foreign host countries . . . [i]t cannot expect to avail itself of the benefits of doing business here without accepting the concomitant obligations." (internal quotation omitted)). Moreover, Respondents fully admit that they knew about the potential impediments of Chinese law when they first registered with the Board in 2004 to 2006. Respondents cannot complain, now that they have proven themselves unwilling to accept the consequences under Chinese law for complying with the U.S. rules they have long known about and consented to, that the SEC is acting unfairly by taking steps to discipline them and potentially curtail their future involvement in U.S. markets.

The Ninth Circuit's decision in *Richmark Corp. v. Timber Falling Consultants*, 959 F.2d 1468 (9th Cir. 1992), reinforces this point. In *Richmark*, the district court imposed discovery sanctions and held Beijing Ever Bright Industrial Co. ("Beijing"), a corporation organized under Chinese laws and an arm of the Chinese government, in contempt for refusing to comply with a discovery order, notwithstanding the fact that complying with the order would constitute a violation of Chinese state secrecy laws. In that case, China's State Secrecy Bureau (the "SSB") had issued to Beijing a written order that explicitly prohibited the company from producing

documents: "In its response to Beijing's request for guidance, the Bureau wrote: '[T]his Bureau hereby orders your Company not to disclose or provide the information and documents requested by the United States District Court . . . . Your Company shall bear any or all legal consequences should you not comply with this order.'" *Id.* at 1476 (quoting SSB order). However, the Ninth Circuit held that this express prohibition on production (which is quite unlike the Chinese government's letters to Respondents here, which merely directed Respondents to follow Chinese law, *see infra*, Argument Section II.D.1) did not excuse Beijing's failure to comply, affirming the district court's contempt order. The court of appeals emphasized: "when Beijing availed itself of business activities in this country, it undertook an obligation to comply with the lawful orders of United States courts." *Id.* at 1479. So too here. Respondents knew the relevant risks but nonetheless took advantage of U.S. markets; once problems arose, they then hid behind Chinese law to avoid compliance with U.S. rules. Such conduct fully supports a finding of willfulness here.

Furthermore, Respondents all made conscious decisions to abide by what they considered to be the legal imperatives issued by the Chinese government, and, therefore, chose affirmatively ***not*** to produce the documents sought by the Requests. *See* Tr. 1357:3-1358:6 (Chao) (PwC Shanghai):

> Q: But your firm knew, in 2012, that it was not producing documents directly to the SEC, correct?
> A: Correct.
> Q: And your firm knows, today, that it has not produced documents directly to the SEC, correct?
> A: Correct.
> Q: And PwC, as a firm, decided in 2012 not to produce those documents, right?
> A: Yes.
>
> *******

Q: But sitting here today, you understand your firm maintains its decision not to produce those documents directly to the SEC, correct?
A: Sitting here today, I'm maintaining my position to ensure we do not breach the law in China and put the firm and our people at risk.
Q: And that decision includes not producing documents directly to the SEC, right?
A: Correct.

See also Tr. 1523: 8-11 (Leung) (EYHM):

Q: Again, Ernst & Young Hua Ming decided that it would not send those documents directly to the United States, correct?
A: Correct.

See also Tr. 2002: 23 – 2003:20 (Yan) (KPMG):

Q: You do know that for failing to comply with the U.S. law, your firm could be barred from appearing or practicing before the SEC, correct?
A: Yes.
Q: And that's a consequence you could live with, correct?
A: No, the consequences we couldn't live with, but I have to comply with Chinese law. I -- well, basically there is a conflict between the two laws. I have to be forced to make a decision.
Q: You were forced to make a decision, correct?
A: We don't have any choice so we need to comply with Chinese law.
Q: Who at your firm decided that it had no choice but to comply with Chinese law? Was it just you, Sir?
A: No. I think we've got a management committee and we've got our chairman so the decision is not mine alone.
Q: You participated in the decision, correct?
A: Yes.

See also April 2, 2012 Letter from Dahua to SEC (**ENF 35**) ("By email dated October 17, 2011 (see attachment 2), we reiterated to the SEC that we would like to provide documents in connection with the SEC's formal investigation, however BDO Dahua ***has decided*** to withhold from the Staff any documents or information responsive to this request due to the potential violations of China's trade secret laws.") (emphasis added).

DTTC has attempted to disclaim responsibility for any such decision. *See* Tr. 1716:14-18 (George) ("On the specific point of can we make a direct production, our local regulators have

been very clear with us that we can't. So there is [sic] no decisions to be made. We have no choice in all this."). However, complying with directions from the Chinese authorities, and withholding documents from the SEC, are by their very nature volitional acts. *See* Tr. 1716: 19-23 (George):

> Q: Well, let's put it this way. When the CSRC told your firm that they could not produce documents directly to the SEC, you followed that direction, correct?
> A: We did.

In choosing to flout U.S. law in favor of Chinese law, Respondents made a calculated business decision that the costs of not complying with Chinese law (or their purported perceptions of Chinese law) were greater than the costs of not complying with U.S. law. As such, Respondents not only acted willfully by refusing to provide the SEC with their audit workpapers, but in essence have already assessed and assented to any potential sanctions arising from that calculation.

B. Respondents Failed To Act In Good Faith

By purposefully entering U.S. markets while determining not to comply with U.S. rules, not only did Respondents knowingly fail to comply with the Requests, they also failed to act in good faith. Consideration of whether a party has acted in good faith in this context must include, among other factors, "whether [the] party's inability to produce documents as a result of foreign law prohibitions was fostered by its own conduct prior to the commencement of the litigation." *Minpeco v. Conticommodity Servs., Inc.*, 116 F.R.D. 517, 522-23 (S.D.N.Y. 1987). Where a party has "'deliberately courted legal impediments . . . [it] cannot now be heard to assert its good faith after this expectation was realized.'" *SEC v. Banca Della Svizzera Italiana*, 92 F.R.D. 111, 117 (S.D.N.Y. 1981) (quoting *Société Internationale*, 357 U.S. at 208-09).

Thus, in *Banca Della*, the court held that a Swiss corporation, which transacted purchases on U.S. securities exchanges, could be compelled to answer certain interrogatories, even though disclosure might subject it to criminal liability in Switzerland. 92 F.R.D. at 113. The court found, in relevant part:

> [The company] acted in bad faith. It made deliberate use of Swiss nondisclosure law to evade in a commercial transaction for profit to it, the strictures of American securities law . . . . [The company] invaded American securities markets and profited in some measure thereby. It cannot rely on Swiss nondisclosure law to shield this activity.

Id. at 117; *see also Minpeco,* 116 F.R.D. at 528-29 (party that entered U.S. markets had "'courted legal impediments to production of the requested documents and information'"); *Richmark*, 959 F.2d at 1479 ("[W]hen Beijing availed itself of business activities in this country, it undertook an obligation to comply with the lawful orders of United States courts.").

So too here, the entirety of Respondents' conduct shows an absence of good faith. Respondents registered with the Board, took on U.S. engagements, and continued these engagements, knowing about the production requirements of U.S. law and the potential constraints imposed by Chinese law. *See supra*, Argument Section II.A. In so doing, "they profited in some measure." *Banca Della*, 92 F.R.D. at 117. Yet they now would make "deliberate use of [Chinese] nondisclosure law to evade . . . the strictures of American securities law." *Id.* Respondents cannot now claim good faith when they knew all along that their own purposeful, profit-motivated conduct could land them in precisely the circumstances in which they now find themselves.

C. Respondents' Decisions To Follow Laws and Alleged Directives Designed To Block The SEC's Access To Workpapers Further Establishes Willfulness

In the event the content of Chinese law needs to be considered at all in determining whether Respondents' actions constituted "willful refusals" (which it need not be), that law –

including the alleged directives issued to Respondents – further demonstrates Respondents' liability under Section 106(e). Rather than comply with their production obligations under Section 106, Respondents chose to follow a purported Chinese legal regime that was designed to block, and in fact did block, the SEC's access to audit workpapers. Respondents' decision to comply with this purported regime despite the knowledge that the SEC possessed no viable alternative means of obtaining the requested documents further shows that they willfully refused to comply with the Requests.

The Restatement of the Foreign Relations Law of the United States defines "blocking statutes" as follows:

> Blocking statutes are designed to take advantage of the foreign government compulsion defense . . . by prohibiting the disclosure, copying, inspection, or removal of documents located in the territory of the enacting state in compliance with orders of foreign authorities. Some statutes cover all documents, some only certain categories (for instance, documents related to merchant shipping or to production of uranium); some statutes apply of their own force, some when invoked by minister or comparable official, and some are applicable unless a waiver is obtained from the competent official or a local court directs that the documents be produced. All blocking statutes appear to carry some penal sanction.

RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 442 Reporters' Note 4 (1987) ("Restatement"). Blocking statutes have long been disfavored as a reason for the non-production of documents located in non-U.S. jurisdictions. In *Societé Nationale Industrielle Aérospatiale v. U.S. Dist. Ct. for Southern Dist. of Iowa*, 482 U.S. 522 (1987), the Supreme Court recognized that "[i]t is well settled that [blocking] statutes do not deprive an American court of the power to order a party subject to its jurisdiction to produce evidence even though the act of production may violate that statute." *Id.* at 544 n.29 (citing *Societé Internationale*, 357 U.S. at 204-206). "American courts are not required to adhere blindly to the directives of such a statute" because otherwise "the language of the statute, if taken

literally, would appear to represent an extraordinary exercise of legislative jurisdiction" by the foreign government over the U.S. court. *Societé Nationale*, 482 U.S. at 544 n. 29; *see also, e.g.*, *Compagnie Francaise d'Assurance Pour le Commerce Exterieur v. Phillips Petroleum Co.,* 105 F.R.D. 16 (S.D.N.Y. 1984) (ordering discovery notwithstanding blocking statute). Given blocking statutes' disfavored status, the purpose of the Chinese laws that Respondents purport to follow here is of particular relevance. If the SEC's ability to sanction Respondents for their conduct affecting U.S. markets and regulatory processes must accommodate Chinese law, this would represent an "extraordinary exercise" of jurisdiction by the Chinese government over the SEC's prerogatives to protect its processes.

Here, the combined practical effect of the laws, regulations, and purported directives of the Chinese government, with which Respondents chose to comply, was to block the SEC's access to the audit workpapers that the SEC needed for its investigations. These laws did not operate to impose broadly applicable safeguards on sensitive state information. Rather, the laws, applied in concert with the Chinese government's alleged oral directives to Respondents and simultaneous refusal to provide audit workpapers to the SEC through existing cooperative mechanisms, specifically functioned to impede the regulatory function of an overseas regulator, the SEC.

1. The Alleged Chinese Legal Regime Relied Upon By Respondents Functioned To Block The SEC's Access To Documents.

The total effect of the alleged legal regime with which Respondents complied was to halt the flow of necessary information to the SEC, and, in so doing, to assert China's sovereignty over every channel by which the SEC might obtain such information, due solely to its status as a foreign regulator. "Once a 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." Rebuttal Expert Declaration of James V. Feinerman ¶13 (filed 7/1/13) ("Feinerman Rebuttal").

Directives from the CSRC and MOF. Respondents themselves emphasize that they were directly and repeatedly instructed by both the CSRC and Chinese Ministry of Finance ("MOF") not to produce audit workpapers and related documents directly to the SEC without prior authorization from these regulators. The CSRC and MOF allegedly delivered their most definitive guidance on the issue in a meeting on October 10, 2011, attended by all of the Respondents and one other firm. This meeting occurred approximately seven months *after* the SEC issued the Section 106 request regarding DTTC Client A **(ENF 127)**; after various SEC investigative teams sent voluntary requests for audit workpapers or other documents to certain Respondents;[33] and after certain Respondents received PCAOB Accounting Board Demands seeking audit workpapers, *see, e.g.*, PCAOB Accounting Board Demand to KPMG Huazhen (6/15/11) **(RX 535)**. Thus, the Chinese government allegedly instructed Respondents not to produce documents specifically in response to requests already received from U.S. regulators.[34]

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[33] *See* Voluntary Request to Dahua regarding Client A (5/19/2011) **(ENF 280)**; Tr. 617:17-618:14 (Weinstein); Voluntary Request to EYHM regarding Client B (6/30/2011) **(ENF 306)**; Tr. 483:16-484:1 (Hubbs); Voluntary Request to EYHM regarding Client C (10/5/2011) **(ENF 59)**; Tr. 272:19-273:25 (Peavler); Voluntary Request to KPMG Huazhen and KPMG Hong Kong regarding Client E (4/28/2011) **(ENF 287)**; Tr. 178:18-179:16 (Rana); Voluntary Request to DTTC regarding Client G (5/5/2011) **(ENF 96)**; Voluntary Request to PwC Shanghai regarding Client I (9/23/2011) **(ENF 113)**; Tr. 375:9-377:17 (Kaiser).

[34] Respondents also variously contend that they received similar oral guidance from the Chinese government: (1) shortly after DTTC first contacted the CSRC about the Request concerning DTTC Client A, *see* Gibson Dunn letter on behalf of DTTC (4/29/11) **(ENF 128)**; (2) during July 2011 meetings between EYHM and, separately, the CSRC and MOF, *see* Tr. 1410:22–1414:12 (Leung); (3) during an October 17, 2011 meeting between PwC Shanghai and the CSRC, *see* Tr. 1295:21-1299:3 (Chao), 1862:23-1863:3 (Debra Wong Testimony); (4) during a December 2011 phone or in-person meeting between EYHM and the CSRC, *see* Tr. 1445:19-1451:5 (Leung); (5) during a February 24, 2012 meeting between the Big Four and, separately, the CSRC and MOF, *see* Tr. 1459:3-1463:19 (Leung); Tr. 1872:22-1876:19 (D.Wong); Tr. 2089:15-2090:8 (Dahua communication with CSRC); (6) during a March 31, 2012 phone call between PwC Shanghai and the CSRC, *see* Tr. 1874; (7) during a May 2012 meeting or phone call between EYHM and the CSRC, *see* Tr. 1467:8-1468:13 (Leung); (8) in a May 2012 "private communication" between Dahua and the CSRC after Dahua received a Wells notice, *see* Tr. 2090:16-

Moreover, it was clear to Respondents that, in issuing the directives, the Chinese government was primarily motivated by concerns about its own sovereignty within its borders. According to PwC Shanghai, the Chinese government "made very clear that this was a sovereign issue and therefore, if there were any requests, we have to work through the CSRC. That was the only appropriate way to do it." Tr. 1295:22-1296:3 (Chao). *See also* Tr. 1297:3-7 ("the directive was very clear. You're not allowed to produce any work paper to a foreign regulator. This is a sovereign issue. We have to work through the CSRC if we have any requests by a foreign regulator."); Tr. 1416:18-20 (Leung) ("we were told by the CSRC that firms are not allowed to provide working papers to foreign regulators.").

Indeed, the Chinese government's alleged directives not to produce documents directly to the SEC applied to Respondents *irrespective* of whether any other Chinese law – written or oral – similarly constrained Respondents. "We were told by the PRC representatives that we cannot produce working paper to the foreign regulators no matter whether it is allowed, disallowed by PRC law." Tr. 1528:5-8 (Leung); *see also* Tr. 1451-15 (same). In particular, Respondents considered themselves bound to the directives *regardless of whether their documents contained any state secrets*. *See* Tr: 1455: 15-19 (Leung) (based on December 8, 2011 meeting with CSRC, "My understanding is that it doesn't matter whether [state secrets or archives] laws disallow any working paper or not, the accounting firms are not allowed to directly produce working papers to foreign regulators.").

No Review of Documents by State Secrecy Bureau. The abandonment of procedures that would have facilitated determinations as to potential state secrets further contributed to the

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2092:17 (Feng); (9) during a December 5, 2012 "private communication" between Dahua and the CSRC and MOF, *see* Tr. 2093:2-2095:12 (Feng); and (10); during a December 10, 2012 meeting between EHYM and PwC Shanghai, among other Respondents, and the CSRC and MOF, *see* Tr. 1469:4-1470:20 (Leung), Tr. 1876:24-1878:2 (D.Wong).

overall blocking effect. China's state secrecy laws indisputably did *not* impose a prophylactic bar on Respondents' production of *all* documents sought by the Requests. At most they affected only those requested documents that *potentially* could have been deemed state secrets. *See* Expert Report of Donald Clarke ¶¶23-37 (filed 6/17/13) ("Clarke Initial Report"). Moreover, under Chinese law, the State Secrecy Bureau ("SSB"), not the CSRC, has final authority to determine what constitutes a state secret. *See* Tr. 2465:6-10 (Xin Tang Testimony) ("According to the current law, that the final authorized entity to determine which piece of information is state secret under state secrecy law, that governmental body is State Secrecy Bureau.").

At least under written Chinese law, Respondents had options for identifying documents that they could produce without violating state secrets laws. Respondents, however, did not follow them. As Professor Clarke explains, to the extent Respondents were unsure whether documents contained state secrets, Chinese law provides that Respondents could have gone to their respective local branches of the SSB and asked these officials to make determinations on those documents. Clarke Initial Report ¶27. But Respondents allegedly did not take this step because, when one Respondent contacted the SSB about submitting documents for a state secrets determination, it was allegedly informed that such requests had to be made by another government agency and would not be entertained from private firms. *See* Bingham letter, at 14 (Mar. 27, 2012) **(ENF 66)**; Tr. 2178:11-2179:2 (J. Wong). *See also* Tr. 1453:19-1454:12 (Leung) (stating that EYHM's failure to request determinations from the SSB was based, in part, on KPMG Huazhen's experience with that agency). Respondents also contend that going to the SSB would have been pointless in light of the directives given to them by the CSRC and MOF. *See* Tr. 2472:19-2473:17 (Tang).[35]

[35] Professor Clarke also explains other steps, under written Chinese law, Respondents could have taken to minimize or eliminate the risk posed by potential state secrets in their documents. *See* Clarke Initial

Respondents contend that the state secrecy laws prevented them from producing any documents to the SEC, but, in the end, protection of state secrets obviously could not have been a significant concern for *all* such documents – either on the part of the government or on the part of Respondents:

- At least eight Clients produced documents concerning business operations or financial records to the SEC upon request. *See supra*, Statement of Facts Section IV (describing productions from DTTC Client A and Clients A, B, D, E, G, H, and I). There is no evidence that the Chinese government ever sanctioned any Client or any of its personnel as a result of such a production.
- None of the Division's 10 investigative teams has ever been informed, by Respondents or the Chinese government (at least not prior to the hearing), that any of the documents sought by the Requests contained state secrets.[36]
- Even under the CSRC's purported new procedures for providing audit workpapers to U.S. regulators – the details of which were revealed for the first time during the July 2013 hearing – the Chinese government is relying on Respondents themselves, with the assistance of an outside law firm (Fangda), to identify documents that are *not* potentially protected under the state secrets laws. *See,*

Report ¶13 ("Chinese law provides mechanisms for an accounting firm to determine whether audit work papers and related documents in its possession contain state secrets."). For example, Respondents' Clients had an independent obligation to mark or otherwise identify state secrets before making such information available to Respondents in the first instance. Thus, Respondents could have consulted with the Clients in reviewing their workpapers that were related to these same Clients. Clarke Initial Report ¶¶20- 27.

[36] *See* Tr. 57:20-23, 73:6-21 (Josephs) (DTTC Client A); Tr. 197:17-198:18 (Rana) (Client E/KPMG Huazhen); Tr. 278:11-279:18 (Peavler) (EYHM/Client C); Tr. 388:6-392:3 (Kaiser) (PwC Shanghai/Client I); Tr. 491:2-492:4 (Hubbs) (EYHM/Client B); Tr. 630:9-634:11 (Weinstein) (Dahua/Omnibus Client A); Tr. 708:3-21 (Chang) (DTTC/Client G); Tr. 758:5-759:2 (Kazon) (KPMG Huazhen/Client D); Tr. 798:6-25 (Boudreau) (KPMG Huazhen/Client F); Tr. 871:25-872:24 (London) (PwC Shanghai/Client H).

e.g., Tr. 1774:2-1778:1 (Chiu Chi Man Testimony) (describing DTTC's 2012 review of Client A workpapers). Thus, the Chinese government itself has confirmed that Respondents always have been capable of identifying documents that may be produced overseas. *See* Tr. 1788:14-21 (Chiu) (CSRC instructed DTTC to use "sound judgment" in identifying potential state secrets).

- Few if any documents are actually likely to be deemed state secrets, Tr. 1808:8-1809:12 (Chiu) (describing reviews of Longtop and DTTC Client A workpapers).

In short, the state secrets law was a pretext for doing nothing to assist the SEC. Respondents and the Chinese government easily could have followed established procedures to overcome any obstacles in response to the Requests.

No Use of Approval Procedures at State Archives Administration. Respondents also did not use procedures set forth on the website of the State Archives Administration ("SSA") for obtaining approval for the transfer of "archives" overseas. Clarke Initial Report ¶41. Because audit workpapers are considered archives under Chinese Archives Law, even copies generally cannot be transferred outside of Mainland China without authorization by the Chinese government. Clarke Initial Report ¶¶35-36; Expert Rebuttal Report of Donald Clarke ¶¶6, 8 (filed 7/1/13) ("Clarke Rebuttal"). Thus, the audit workpapers sought by the Requests were subject to a blocking statute, the Archives Law, in the first instance. Clarke Rebuttal ¶8.[37] But here, the Archive Law's blocking characteristic was exacerbated by the non-use of available approval procedures. KPMG Huazhen contends that it contacted the SAA to inquire about obtaining necessary approvals for producing the requested workpapers, but allegedly was told –

[37] Moreover, if Respondents' expert, Professor Tang, is correct that the Archives Law may impose criminal liability for documents that do not constitute state-owned archives, *see* Tr. 2421:18-25, 2423:24-2425:12 (Tang), this would only reinforce the nature of the Archives Law as a blocking statute. *See* Clarke Rebuttal Report ¶8 n.4.

contrary to the guidance on the SAA's website and again without any memorializing letter, Tr. 2220:23-2224:4 (J. Wong) – that the SAA would not help. *See* Bingham letter, at 14 (Mar. 27, 2012) **(ENF 66)**; Tr. 2178:11-2179:2 (J. Wong). In any event, as with state secrets and the SSB, Respondents also contend that going to the SAA for approval regarding archives would have been pointless in light of the directives given to them by the CSRC and MOF. *See* Tr. 2472:19-2473:17 (Tang).

Regulation 29. Finally, Respondents' reliance on Regulation 29 further confirms that the legal regime which they allege prevented their production of requested documents was, in fact, a system designed to block access to these documents by foreign regulators. Regulation 29 was issued jointly by the CSRC, the SSB, and the SAA in 2009. *See* Clarke Initial Report ¶45 & Ex. 2, Item 9. To the extent Regulation 29 imposed any requirements at all on Respondents with respect to the Requests, including (Respondents allege) notifying and obtaining approval from the CSRC, it did so only because the Requests were issued by an "overseas regulatory authorit[y]," namely the SEC.[38]

2. Respondents' Decisions To Abide By China's Blocking Regime Were Willful Refusals

Each Respondent's decision to follow the Chinese government's alleged dictates, and to withhold the requested workpapers in violation of Section 106, was a death knell to the SEC's hopes of obtaining the information it needed to advance its investigations. That was because, at the same time the CSRC and MOF gave their instructions to Respondents, the CSRC was itself refusing to provide workpapers in response to the SEC's requests for assistance under the IOSCO MMOU, thus effectively shutting down the only other avenue through which the SEC

[38] In Professor Clarke's opinion, Regulation 29 did not require Respondents to obtain approval of the CSRC before producing any audit workpapers directly to the SEC in response to any of the Requests. *See infra*, Argument Section II.D.1.

could potentially have obtained the workpapers. Despite issuing platitudes to the effect that the nations' regulators should "work together and consult to find a solution through the co-operative regulation mechanism," October 26, 2011 Reply **(RX 246; Expert Report of Xin Tang (filed 6/17/13), Ex. 2, Item 4 ("Tang Initial Report"))**, the CSRC stonewalled the SEC's repeated and diligent efforts to use the existing "mechanism," the MMOU, to which the CSRC already had agreed to abide.

Specifically, in response to the SEC's request for assistance for DTTC's workpapers regarding DTTC Client A, the CSRC collected the documents from DTTC in 2010, but never delivered them to the SEC, despite three years of follow-up by the SEC. Tr: 70:22-24 (Josephs); Tr. 972:15-21 (Arevalo); Declaration of Alberto Arevalo ¶¶13, 33, 56 (12/3/13) ("First Arevalo Decl.") **(ENF 326)**. Similarly, the CSRC never responded to the SEC's requests for assistance regarding DTTC's workpapers for Client G. Tr. 979:4-15 (Arevalo); First Arevalo Decl. ¶26 **(ENF 326)**. Indeed, for four and one-half years (since 2009), at least until the hearing in these proceedings started in July 2013, the CSRC did not provide the SEC with meaningful assistance with respect to any of the SEC's 23 requests for assistance under the IOSCO MMOU. Tr. 964-967 (Arevalo); Second Declaration of Alberto Arevalo ¶5 (4/29/13) ("Second Arevalo Decl.") **(ENF 327)**; First Arevalo Decl. ¶¶4, 59 **(ENF 326)**. Thus, Respondents' refusals to comply with the Section 106 Requests, allegedly based on instructions from the CSRC, completed the total blockade of the information sought by the SEC.

Respondents fully understood the consequences of their actions. The difficulty U.S. regulators had encountered from Chinese regulators with regard to oversight of audit firms in China, including inspections of them, was well known. *See e.g.* Progress on PCAOB International Inspections Feb. 3, 2010 and attachments, including "Registered Firms Not Yet

Inspected Even Though Four Years have Passed Since Issuance of An Audit Report While Registered (As of Dec.31, 2009)," available at http://pcaobus.org/News/Releases/Pages/02032010_Progress_IntlInspections.aspx. When Respondents refused to comply with the Section 106 Requests, they had no reasonable assurance that the SEC would ever obtain the requested documents. To the contrary, Respondents had every reason to expect that the documents would *not* be available to the SEC within any reasonable timeframe. DTTC knew when it received the Request regarding Client A in March 2011 that the CSRC had not produced to the SEC the documents that DTTC had provided to the CSRC in 2010. DTTC also knew in February 2012 that the CSRC still had not produced the same documents to the SEC, because it was only then – 20 months after the SEC's first request for assistance to the CSRC regarding Client A in June 2010 – that the CSRC allegedly provided instructions to DTTC for screening the requested documents for state secrets. See Tr. 1771:20-1775:2 (Chiu).[39]

[39] DTTC's knowledge of the CSRC's lack of production of the Client A workpapers to the SEC is reasonably attributed to the other Respondents. The other Respondents attended many of the same meetings with the CSRC and MOF as did DTTC, and Respondents undeniably shared information with each other on the issue of U.S. regulators' access to their workpapers. For example, KPMG Huazhen received the CSRC's October 11, 2011 letter addressed to DTTC (Correspondence No. 413 **(RX 245)** no later than the next day, October 12, 2011. *See* October 12, 2011 Len Jui email to CSRC attaching copy of Correspondence No. 413 with his hand edits **(ENF 335-A)**. In addition, the SEC's inability to obtain audit workpapers from China for its investigations was the subject of public discussion. *See* In China, Little Urge to Audit the Auditors, *The New York Times*, July 12, 2012 ("But the S.E.C. has no authority to obtain documents or interview witnesses in China. Without cooperation from Chinese authorities, there is no way for the commission to either put such suspicions to rest or conclude they are accurate and file a suit."); *See also* Speech of Lewis H. Ferguson, Board Member, PCAOB, "Investor Protection through Audit Oversight" at California State University 11th Annual SEC Financial Reporting Conference Sept. 21, 2012 ("There is, however, a second and complicating issue with China and Hong Kong. Both the PCAOB and the SEC are in discussion with Chinese authorities about cooperation in connection with investigative activities. Both agencies are seeking the cooperation of the Chinese authorities in obtaining documents in appropriate investigations. Although we remain hopeful that breakthroughs will be achieved, to date difficulties remain."). Furthermore, it should have been apparent to Respondents, by at least February 2012, from their receipt of the Section 106 requests, that the SEC had not obtained the CSRC's cooperation on the issue.

In sum, Respondents chose to abide by a foreign legal regime that effectuated a total blockade against the SEC's receipt of the documents that it sought, either through the Section 106 Requests with which Respondents were required to comply, or requests to the CSRC under existing international protocols. Respondents' refusals to comply with the Requests under these circumstances, including the knowledge that the SEC was in all likelihood foreclosed from obtaining the documents through any other means, further demonstrates willfulness.

D. Respondents' Refusals Were Willful Regardless Of Their Purported Reliance On Unverifiable Oral Guidance From Chinese Regulators

Even assuming a foreign-law defense is potentially available under Section 106(e), which it is not, Respondents cannot avail themselves of such a defense. The Chinese "law" on which they purported to rely consisted primarily, if not exclusively, of secret and unverifiable oral directives that Respondents allegedly received from the CSRC and MOF. Such alleged impediments are insufficient to establish a "good faith inability to comply with document demands due to foreign law" or "justifiable excuse."

1. The Law That Allegedly Constrained Respondents Was Oral Law

Since Respondents received their first requests from the SEC for audit workpapers (either voluntary or under Section 106), they have contended that a variety of Chinese laws and rules prevented them from complying with those requests. *See supra*, Statement of Facts Section IV. However, to the extent Respondents faced actual legal constraints in complying with the Section 106 Requests, these constraints were imposed by alleged, non-public, oral directives from the CSRC and MOF, not by written law. Indeed, Respondents still have not cited a single, written law or rule requiring that Respondents' primary Chinese regulator in this area – the CSRC – approve Respondents' production to the SEC of any of the specific documents sought by the Requests. *See* Clarke Initial Report ¶12, *passim*. Throughout these proceedings Respondents

have attempted to conflate the various laws, both written and oral, to which they claim they are subject. *See, e.g.*, Tr. 2459:4-2460:20 (Tang) (referring to multiple PRC laws in attempting to explain how the Reply indicates that Respondents should not provide audit workpapers directly to foreign regulators). Yet none of the written laws that they have cited, standing alone, tied their hands. To the contrary, these written laws provided procedures that, if followed, could have facilitated Respondents' cooperation with the SEC.

Moreover, Respondents have not substantiated any claim that violation of oral directives from the CSRC, assuming such existed, could lead to criminal liability. They have not pointed to any provision of China's Criminal Law, or any other statute providing for criminal sanctions, that would impose liability in such circumstances. In the absence of a statute prescribing a punishment, and with no cited examples of criminal sanctions in comparable situations, Respondents' claim of potential criminal liability resulting from the oral directives is wholly unsupported.

Regulation 29. There can be no doubt that Regulation 29 "is exactly on point" and "is an important document in understanding the obligations of accounting firms," among others in China, that receive requests for documents from overseas regulators such as the SEC. Clarke Initial Report ¶45.[40] As Professor Clarke explains, Article 8 of Regulation 29 expressly requires accounting firms in China to report requests for *on-site* inspections to the CSRC; however, it does not impose a similar requirement for requests for *off-site* inspections such as the Requests.

[40] *See* Declaration of Xin Tang in Longtop proceeding ¶20 (4/11/12) ("Tang Decl.") ("Regulation 29 is one of the *principal* legal bases that will be taken into consideration in determining whether DTTC is able to provide Longtop's Audit Workpapers to the U.S. Regulator") **(ENF 338)** (emphasis added); Gibson Dunn letter on behalf of DTTC (4/29/11) **(ENF 128)**. Professor Tang in his hearing testimony appeared to downplay the importance of Regulation 29, suggesting that his earlier statements in Longtop about the role of Regulation 29 could not be applied to these proceedings, because these proceedings involve additional audit firms and clients and, therefore, are "more complicated." Tr. 2438:22-2440:17 (Tang). These explanations are unpersuasive. Whether and how Regulation 29 applies in a particular case should not depend on the number of requests from a foreign regulator.

See Clarke Initial Report ¶¶44-55; Tr. 2336:6-2338:18 (Donald Clarke Testimony). Professor Tang attempts belatedly, in his rebuttal report, to argue that certain provisions of Regulation 29 required notification to, and approval from, the CSRC even for off-site inspections. But his arguments lack specificity and do not overcome Professor Clarke's structural analysis of Article 8 of Regulation 29. *See* Rebuttal Expert Report of Xin Tang ¶¶20-34 (filed 7/1/13) ("Tang Rebuttal").[41]

State Secrets. Under written Chinese law, Respondents could have at least reviewed the documents sought by the Requests, determined which of them clearly did not implicate state secrets and produced them to the SEC without fear of sanction under those laws, and then sought assistance – including from the SSB – to determine whether any of the remaining documents contained state secrets. *See* Clarke Initial Report ¶13 ("Chinese law provides mechanisms for an accounting firm to determine whether audit work papers and related documents in its possession

[41] Professor Tang's initial expert report provides only a summary conclusion about Regulation 29 and does not analyze any of its provisions. *See* Tang Initial Report ¶41. Professor Feinerman, for his part, simply agrees with Professor Tang's conclusions about Regulation 29 and also does not provide any independent analysis. *See* Expert Report of James V. Feinerman ¶4 (fourth bullet), ¶41 (filed 6/17/13) ("Feinerman Initial Report"); Feinerman Rebuttal ¶31. In the Tang Rebuttal, Professor Tang tries to support his position through Articles 6 and 7 of Regulation 29. He points out that, under Article 6, certain categories of workpapers – those "involv[ing] any state secrets, national security or vital interests of the State" – must receive "the approval of *relevant in-charge authorities*" before they are transferred overseas. Tang Rebuttal Report ¶21 (emphasis added); *see also* Regulation 29 Art. 6, set forth in Tang Initial Report, Ex. 2, Item 15. But this provision addresses only a limited subset of workpapers and, in any event, Professor Tang's quotation simply begs the questions of which Chinese government agencies are the "relevant in-charge authorities" under it. Professor Tang then quotes Article 7, which authorizes "[t]he *relevant in-charge authorities such as the China Securities Regulatory Commission*, the State Secrets Bureau and the State Archives Administration" to "establish a coordination mechanism" for matters within their respective scopes of authority. Tang Rebuttal ¶22 (emphasis added); *see also* Regulation 29 Art. 7, set forth in Tang Initial Report, Ex. 2, Item 15. But again, this provision addresses a different set of governmental responsibilities. Neither Article 6 nor Article 7 specifically provides that the CSRC is one of the "other relevant authorities" that must be contacted under Article 8 when an audit firm receives a request for an on-site inspection (regardless of the types of documents sought by the request), whereas Article 8 *does* specifically require that the CSRC be contacted for on-site inspections. *See* Regulation 29, Art. 8. Professor Tang's repeated, mixed references to Articles 6, 7, and 8 of Regulation 29 in the Tang Rebuttal fail to establish that any of these provisions required notification to, and approval by, the CSRC for any of the requests for off-site inspections contained in the SEC's Section 106 demands at issue.

contain state secrets."); *id.* ¶¶20- 27 (outlining additional mechanisms, including consulting with Clients who had an independent obligation to mark or identify state secrets).

Archives. Under written Chinese law, Respondents could have at least availed themselves of documented procedures for obtaining the SAA's approval to transfer audit workpapers (considered archives) abroad. Clarke Initial Report ¶41. As written, the Archives Law did not require approval from the CSRC or MOF. Additionally, there is no criminal sanction for transferring without authorization non state-owned archives that do not contain secrets. *Id.* ¶40. Although Respondents argued vaguely to the contrary, they were unable despite repeated opportunities to identify any law specifying what exactly the criminal sanction might be.[42]

Other Chinese Law Provisions. Supposed obstacles that other Chinese laws impose against the production of audit workpapers to foreign regulators are similarly exaggerated.

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[42] China's Criminal Law, Article 329, states: "Whoever, in violation of the Archives Law, sells or transfers *state-owned records* without authorization, shall if the circumstances are serious be sentenced to not more than three years of fixed-term imprisonment or criminal detention." Clarke Initial Report Ex. 2, Item 6 (emphasis added). As Professor Clarke notes, none of the Respondents has asserted or now asserts that the workpapers requested by the SEC are state-owned archives, and, therefore, no criminal liability could attach to their unauthorized transfer barring state secrets concerns. Clarke Initial Report ¶40. Neither the Tang Rebuttal nor the Feinerman Rebuttal tries to refute Professor Clarke on this point. During the hearing, when Professor Tang was asked what circumstances involving violations of the archives law could give rise to criminal liability, he did not "remember it that well." Tr. 2421:2-6 (Tang). Although he then argued that Article 24 of the *Archives Law* could provide a basis for criminal liability for certain misconduct related to archives, Tr. 2421:18-25, 2423:24-2425:12 (Tang), this belated claim does not withstand scrutiny. Article 24 identifies certain acts that could lead to administrative sanctions, and further states, "and *if* the case constitutes a crime, criminal responsibility shall be investigated according to law." Archives Law, Art. 24, set forth at Tang Report, Ex. 2, Item 2 (emphasis added). Plainly this language refers to China's Criminal Law for a determination of what may constitute criminal conduct and does not independently establish criminal liability for any of the acts identified in Article 24 of the Archives Law. That there is no criminal liability for the unauthorized transfer of non-state-owned archives is immediately clear from the statute's lack of any specified punishment. As noted above, the Criminal Law provides for up to three years of imprisonment in the case of state-owned archives. Respondents have identified no Chinese law spelling out the specific criminal punishment for transferring non-state-owned archives without authorization. Moreover, Respondents have cited no case involving a determination of criminal liability under Article 24 of the Archives Law, or, for that matter, under any other law for conduct expressly involving improper acts with archives.

DTTC Prehearing Brief, at 27 (citing Law of the People's Republic of China on Certified Public Accountants "CPA Law"; Criminal Law of the People's Republic of China "PRC Criminal Law"). Professor Clarke explains that, as a matter of practice, the CPA Law does not appear to bar Respondents' production of workpapers, Clarke Initial Report ¶ 59, and even if it did, Respondents could have insulated themselves from potential liability under the CPA Law by simply obtaining waivers from their Clients. *Id.* at ¶¶ 60-61. Similarly, any potential criminal liability accruing to Respondents by virtue of compliance with the Requests was curable by Client consent. *Id.* at ¶ 62.

The CSRC's "Reply" Letter. Finally, the correspondence issued by the CSRC to Respondents in October 2011, following meetings between Respondents and the CSRC and MOF, does not contain any express prohibition on the production of documents to the SEC either. Like the meetings, the correspondence was non-public and directed only to the meetings' attendees. *See, e.g.*, Tr. 2116:12-20 (Feng). The CSRC issued three such letters: one dated October 11, 2011, addressed to DTTC (CSRC Correspondence No. 413) **(RX 245)**; a second dated October 17, 2011, addressed to KPMG Huazhen (CSRC Correspondence No. 422) **(RX 546)**; and a third dated October 26, 2011, addressed to "The Relevant Accounting Firms" (CSRC Correspondence No. 437) **(RX 246)**. But each of these letters "simply instructs recipients to follow existing law, something they were already required to do." Clarke Initial Report ¶43; *see also* Clarke Rebuttal Report ¶¶14-18. Respondents' expert Professor Tang provided the most reliable English translation of Correspondence No. 437 (the "Reply"), which "culminated" from the two earlier letters and is attached as an exhibit to both of his expert reports. *See* Tr. 2448:9-2449:1 (Tang) ("I myself made the translation of the reply. . . . I did my very best to seek the most accurate translation."); Tang Report ¶11; Reply **(Tang Report Ex. 2, Item 4; also RX**

246); *see also* Tr. 2342:8-2343:12 (Clarke) (agreeing that Professor Tang's Reply translation was accurate in all material respects).

Respondents' contention that the Reply prohibited them from complying with the Requests is belied by the Reply's language. Respondents point to the fourth and last paragraph of the Reply, *see, e.g.*, Tr. 2114:8-19 (Feng); Copy of Reply with Chinese version marked in pen by Feng **(ENF 350 (RX 246))**, but this paragraph states only, in relevant part:

> Those, who *in violation of* the relevant laws, regulations and provisions, provide the audit archives and other documents overseas *without authorization* shall be subject to legal liabilities imposed by the relevant government departments.

Reply **(RX 246)** (emphasis added). Thus, the Reply provides that the Chinese government may sanction CPA firms that send documents overseas without authorization, *where such authorization is required*. *See* Clarke Rebuttal ¶17; Tr. 2344:21-2345:25 (Clarke).[43] The Reply does not impose on Respondents a standalone prohibition on producing documents to foreign regulators, or state that Respondents must always obtain the CSRC's or anybody else's permission before doing so. Respondents themselves contrasted the Reply with what the CSRC purportedly communicated during the October 10, 2011 meeting, by stating that the government's oral directive was more "blunt," Tr. 1953:17-1954:6 (Yan), and the Reply was "watered down," Tr. 1954:12-19, and even by trying, unsuccessfully, to "edit" the Reply before it was issued, *see* October 12, 2011 email from Len Jui, KPMG Huazhen, to Haijun Li, CSRC **(ENF 335)** and certified translation **(ENF 335-A)**; Tr. 1976:5-6 (Yan) (Len Jui "said he wanted to make the letter more clear, in more context.").

[43] As noted above, the Chinese government knows how to provide an express written directive. *See Richmark Corp.*, 959 F.2d at 1476 (quoting SSB's written directive "hereby order[ing] your Company not to disclose or provide the information and documents requested."); *supra*, Argument Section II.A.

Finally, Respondents' purported reliance on the Reply is undercut by their own desperate attempt during the hearing to substitute a new English translation for the one originally created and vouched for by their own native-speaking, legally-trained, Chinese law expert. The new translation conspicuously omits the phrase "in violation of the relevant laws." *See* Respondents' Alternative Reply Translation ("Respondents' Alternative Reply") **(RX 246-A)**.[44] But even this new translation does not require Respondents to obtain CSRC approval before producing any documents.[45] In any event, the record overwhelmingly demonstrates that Professor Tang's English translation **(Tang Report Ex. 2, Item 4; RX 246)**, which does contain the "in violation of relevant laws" phrase, is the more substantively accurate translation. First, Professor Clarke, who has 40 years of training in the Chinese language, testified precisely as to which Mandarin characters constitute this phrase. *See* Tr. 2343:13-17 (Clarke). Second, Professor Tang confirmed the presence of the phrase in his Longtop declaration. *See* Tang Longtop Decl. ¶26(b) **(ENF 338)** (emphasis added). Third, Respondents themselves provided at least two other alternative translations that also contained this phrase. *See* PwC Shanghai Wells submission (5/29/12), attachment (PwC_Zhong_Tian_WA_000049) **(RX 395) (also contained in ENF 158)**; EYHM certified translation **(RX 20-A)**. Fourth, the Division also provided a certified translation with the phrase. **(ENF 328-A)**[46]

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[44] The last sentence of Respondents' Alternative Reply states: "Firms who provide audit archives and other documents overseas without authorization shall be subject to legal liabilities." **(RX 246-A)**.

[45] Even if the Reply simply prohibits the provision of audit working papers "overseas without authorization," "[w]e still need to answer the question whose authorization is required;" under "Regulation 29, clearly we have the possibility of State Secrets Bureau authorization required, we have the possibility of Archives Administration authorization required, but I don't see the requirement for CSRC's authorization." Tr. 2346:18-2347:6 (Clarke).

[46] Against this near-unanimous agreement on the Reply's correct translation, the only English translation in the record that does not contain the "in violation of law" language, besides Respondents' belated Exhibit 246-A, is Respondents uncertified Exhibit 20 **(RX 20)**, which apparently originated from EYHM. However, the record is silent on who actually created this translation and the translator's qualifications.

2. Resort to Oral Law Cannot Suffice As An Affirmative Defense Under Section 106(e)

Because the record at most shows only that Respondents were constrained by the oral directives they received – or, alternatively, by written laws construed in light of those oral directives – Respondents cannot make any requisite showing that they were justifiably excused from the requirements of Section 106. This is so for at least three reasons.

First, because the alleged directives relied upon by Respondents were oral and nonpublic and unsupported by any written or sworn statement by the Chinese government, they are incapable of independent verification and, therefore, inherently unreliable. Hearsay testimony is generally admissible in SEC administrative proceedings; however, "[i]n determining whether to rely on hearsay evidence, it is necessary to evaluate its probative value and reliability, and the fairness of its use." *In re Joseph Abbondante*, Exchange Act Rel. 53066, 58 S.E.C. 1082, 1101 (Jan. 6. 2006). The weight that each hearsay item receives depends on its separate "truthfulness, reasonableness, and credibility." *Johnson v. U.S.*, 628 F.2d 187, 190-191 (D.C. Cir. 1980) (citing treatises and Supreme Court cases). In deciding whether to rely on such hearsay, the ALJ should consider, among other factors, "the possible bias of the declarant, the type of hearsay at issue, whether the statements are signed and sworn to rather than anonymous, oral or unsworn . . . and whether the hearsay is corroborated." *Joseph Abbondante*, 58 S.E.C. at 1101 n.50.

Here, Respondents' proffered hearsay is unreliable and unfair for its intended purpose – total exoneration from liability – because it is wholly self-serving and uncorroborated by any independent source. Indeed, the hearsay is starkly different from the CSRC correspondence intended to memorialize the alleged directives. This is true even though Respondents tried

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Moreover, Professor Clarke testified that the English translation in Respondents' Exhibit 20 is inaccurate. *See* Tr. 2345:2-3 ("It's not consistent with my understanding of what the Chinese means.").

unsuccessfully to edit the correspondence; the CRSC's rejection of these edits supports only the inference that the CSRC had a different view of what occurred at the meeting. *See also* Gibson Dunn letter on behalf of DTTC (4/29/11) (stating CSRC informed DTTC that it "could not provide a written confirmation of its position" that DTTC allegedly was prohibited from making a direct production to the SEC). Insofar as the alleged oral directives and correspondence conflict, there is no reason to give greater weight to the oral hearsay testimony than to the contents of correspondence bearing an official seal. In short, the hearsay testimony is too unreliable to merit any significant weight, and too flimsy to support Respondents' claims of "good faith" in the face of significant evidence to the contrary.

More generally, the SEC's ability to protect its processes – and U.S. investors – from non-transparent audits should not turn primarily on a non-compliant auditor's self-serving hearsay testimony (or even several such testimonies) about the oral, unsworn statements of a foreign regulator. If such testimony were sufficient, the integrity of the SEC's processes would be subject to any foreign firm's claim that it had received an oral instruction from a foreign regulator. Because the SEC has virtually no recourse effectively to challenge such an out-of-court statement, the SEC's protective powers under Sarbanes-Oxley Section 106(e) and Rule 102(e) would be nullified. Particularly where, as here, the total effect of the firm's compliance with the alleged foreign instruction is to achieve a total blockade against the SEC's access to documents, *see supra*, Argument Section II.C, the alleged oral, secret instructions should be deemed insufficient. Yet such hearsay testimony is all that Respondents have offered in this case.[47]

[47] Respondents contend that their witnesses' testimony regarding various meetings with PRC authorities does not constitute hearsay because Respondents are "offering [the testimony] for the fact that [the meetings] occurred." Tr. 2015:6-2016:5 (Ruthberg). This contention fails. While the Division does not concede that the contents of the purported meetings, even if accurately represented by Respondents,

Second, even if it could be theoretically acceptable for Respondents' liability under Section 106(e) to hinge on the Division's refuting oral hearsay testimony, it still remains unclear whether the Chinese government's oral statements would be binding. As Respondents' expert acknowledged, whether such oral directives are binding depends on the facts and circumstances of the oral statement at issue, including what was said, whether the regulator was acting within the scope of its regulatory authority, and the "importance that the [regulator] attaches to" the directive. Tr. 2558:11-2560:18 (Feinerman). The uncertainty that may arise on these issues further counsels against a defense predicated exclusively, or even primarily, on hearsay testimony.

Third, not only were the alleged official directives to Respondents oral and secret, they were also *ad hoc*. For all of these reasons, they present an undue risk that one or more of the Respondents could have colluded with the Chinese government to obtain the "directive" they wanted. As the record demonstrates, such risk of collusion is no mere hypothetical worry. First, the SEC is generally not in a position to ensure the integrity of foreign government processes, particularly those that are hidden from public view. Second, Respondents with potential liability for U.S. securities law violations (or who otherwise want to avoid scrutiny) obviously have an interest in shielding their documents from U.S. regulators. Third, during the relevant period, Respondents had repeated contacts with the CSRC through in-person meetings, phone calls, and emails. *See, e.g.*, Tr. 2089:1-3 (Feng) ("So I personally phoned the CSRC officials and asked

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would excuse Respondents' willful violations of Section 106, Respondents' defense here is premised almost entirely on what PRC government officials supposedly said at the meetings: that Respondents were forbidden to comply with the Section 106 Requests. Respondents cannot have it both ways; they cannot argue that the oral directives that they received were binding, and at the same time argue that the truth of whether or not they are binding is irrelevant.

about it. I asked them why they still hadn't sent the document . . . ."); *supra*, Argument Section II.C.1 n.34 (listing Respondents' meetings with CSRC and MOF).

Finally, in at least one instance, Respondents attempted (apparently without success) to shape the CSRC's directives regarding compliance with the Requests. On October 11, 2011, the day after the October 10 meeting between the CSRC and Respondents, the CSRC issued a reply correspondence (Correspondence 413) addressed specifically to DTTC. **(RX 245)**. Shortly thereafter, Len Jui, the head of KPMG Huazhen's regulatory and public affairs unit, obtained a copy of Correspondence 413. Apparently dissatisfied with its content and viewing the letter as not restrictive enough, on October 12, 2011, Jui (who did not attend the October 10 meeting) emailed the CSRC in a blatant attempt to control the content of a separate written correspondence that KPMG Huazhen expected to receive back from the CSRC at a later date. **(ENF 335)** Specifically, Jui emailed to the CSRC a proposed edit to the official, stamped version of Correspondence 413.[48]

From these established facts, it must be inferred, at a minimum, that: (1) Respondents acted on a coordinated basis with each other, including by sharing their private correspondences received from the CSRC, in order to manage the official messages being issued by the CSRC; and (2) although Respondents formally submitted written "requests" for direction to the CSRC, these requests did not reflect actual attempts to obtain the CSRC's permission to produce documents directly to U.S. regulators; indeed, KPMG Huazhen's email sought to shape a CSRC reply that would *not* grant such permission. Thus, regardless of what actually occurred during Respondents' meetings with the CSRC, the record supports a finding of some level of collusion

[48] The proposed edit would have changed the second substantive paragraph of the Reply to state: "Audit working papers and archive materials provided outbound by accounting firms . . . should be approved by the corresponding legal procedures as well as the relevant authorities." **(ENF 335-A)** (proposed edit in underline).

between Respondents and the Chinese government. The dubious circumstances in which the CSRC allegedly issued directives to the Respondents further weigh against a finding that Respondents were justifiably excused in refusing to respond to the Requests based on supposed Chinese law.

III. OTHER COMITY CONSIDERATIONS DO NOT MAKE RESPONDENTS' CONDUCT LESS "WILLFUL"

Respondents contend that they have not "'willfully refused' to comply with the Requests because those requests themselves are not enforceable under established principles of international comity." DTTC Prehearing Br. 36. But the comity factors that a federal court would apply under the Restatement in the enforcement context do not apply in these Rule 102(e) proceedings. In any event, to the extent these factors – including good faith – are considered, they weigh decisively in favor of a finding that all Respondents willfully refused to comply with the Requests under Section 106(e).

A. Traditional Comity Analysis Does Not Apply To These Proceedings

1. Traditional Comity Analysis Does Not Apply Because The Division Does Not Seek To Compel Compliance With The Requests

Respondents' invocation of comity-based arguments, in support of their position that Section 106(e) cannot impose liability unless the underlying requests are "enforceable," repeats Respondents' fundamental mistake: comity-based arguments are unavailing because the Division does not seek to "enforce" the Requests through these proceedings. *See supra*, Argument Section I.C.2. "Comity refers to the spirit of cooperation in which a domestic tribunal approaches the resolution of cases touching the laws and interests of other sovereign states." *Societé Nationale*, 482 U.S. at 544 n. 27. Accordingly, a comity analysis based on the Restatement factors is appropriately applied "in evaluating the propriety of an [order] directing

the production of information or documents located abroad where such production would violate the law of the state in which the documents are located." *Minpeco*, 116 F.R.D. at 522; *see also Gucci America, Inc. v. Weixing Li*, No. 10cv4974 (RJS), 2011 WL 6156936, at *5 (S.D.N.Y. Aug. 23, 2011) (applying factors from Restatement § 442(1)(c) "[i]n determining whether to order a party to produce documents in contravention of the laws of a foreign country").

But where, as here, the Division seeks no order to compel production, there is simply no occasion "to accord respect to the sovereignty of states in which evidence is located." *Société Nationale*, 482 U.S. at 543. Nothing that the ALJ or the Commission resolves through these proceedings "touch[es] the laws and interests" of China or any other country besides the United States, *id.* at 544 n.27, because "[t]he Division is plainly not seeking to enforce the requests or obtain documents through these proceedings . . . .," April 30 Order, at 7. Rather, the Commission instituted these proceedings to determine whether Respondents willfully violated Sarbanes-Oxley, and, therefore, whether they should be denied the privilege of appearing and practicing before the Commission. Any remedy that might result from these proceedings implicates only the Respondents' prerogatives *within the United States*; it does not threaten to offend the decision-making authority of any foreign sovereign. Because these proceedings do not seek to compel any conduct that would occur overseas or otherwise might conflict with foreign law, there is simply no reason for the ALJ – or for the Commission generally – to exhibit comity toward foreign law here.

2. Traditional Comity Analysis Does Not Apply Because Respondents Do Not Carry Their Burden of Showing An Actual Conflict of Law

Comity analysis is inapplicable for the additional, separate reason that Respondents have not carried their burden of showing an actual conflict of law. Assuming, *arguendo*, the Division were seeking to enforce compliance with its Requests through these proceedings (which it is

not), Respondents would bear the burden of showing an actual conflict of law because they are the parties that have resisted discovery. *See In re Sealed Case*, 825 F.2d 494, 498 (D.C. Cir. 1987) ("one who relies on foreign law assumes the burden of showing that such law prevents compliance with the court's order."); *SEC v. Euro Security Fund*, 1999 WL 182598, at *3 (S.D.N.Y. Apr. 2, 1999) (the party opposing discovery bears the burden of proving the existence of an actual conflict between the foreign law and U.S. discovery obligations). Respondents do not carry this burden because, at best, they show only that they are constrained by the *ad hoc*, secret, and oral directives of the Chinese government, not written law. *See supra*, Argument Section II.D.1. The Commission has no reason even to consider deferring to Chinese law when the Chinese government does not clearly set forth its supposed position in a public document.

B. The Comity Factors Only Further Demonstrate That Respondents Willfully Refused To Comply With the Requests

In any event, the comity factors, to the extent considered, only reinforce the conclusion that Respondents willfully violated Sarbanes-Oxley. Following Supreme Court precedent, where a party resists compliance with discovery in reliance on foreign law, courts consider the party's good faith along with factors drawn from the Restatement, including: (a) the competing interests of the nations whose laws are in conflict; (b) the extent and nature of hardship of compliance for the party or witness from whom discovery is sought; (c) the extent to which the required conduct is to take place in the territory of the other state; (d) the nationality of the person; (e) the importance to the litigation of the information and documents requested; and (f) the ability to obtain the subpoenaed information through alternative means. *See, e.g.*, *Société Nationale*, 482 U.S. at 544 n.28 (endorsing Restatement factors as relevant to comity analysis); *Banca Della Svizzera*, 92 F.R.D. at 116-17 (collecting cases); *Minpeco*, 116 F.R.D. at 523; *Euro Sec. Fund*,

1999 WL 182598, at *3; *cf. Bank of Nova Scotia*, 691 F.2d at 1389-91 (applying similar balancing test in the context of a grand jury subpoena).

1. The U.S. Has A Stronger Interest In Preventing Non-Transparent Audits Then China Has In Blocking Regulators' Full Access to Workpapers.

"[T]he most important" of the Restatement factors is the "Balance of National Interests." *Richmark*, 959 F.2d at 1476; *Wultz v. Bank of China*, 910 F. Supp. 2d 548, 558 (S.D.N.Y. 2012) ("[T]his factor – the balancing of national interests – is the most important, as it directly addresses the relations between sovereign nations." (internal quotation omitted)). Here, the United States' interests in obtaining the requested documents, which are necessary for ongoing investigations into financial frauds on the domestic securities markets, far outweigh China's interests in secrecy and sovereignty. Prior courts have reached a similar conclusion when considering whether foreign states' secrecy laws preclude compliance with SEC information requests. *See, e.g.*, *Euro Sec.*, 1999 WL 182598, at *4; *Banca Della Svizzera*, 92 F.R.D. at 117. Now that the SEC has been denied the documents that it sought, the U.S. has an equally paramount interest, on a prospective basis, in protecting U.S. investors from relying on filed financial statements over which the SEC cannot exercise appropriate oversight by virtue of auditors' non-compliance with information requests. *See Arthur Young*, 465 U.S. at 817-18.[49]

Respondents contend that "the SEC's interests in the documents at issue are not as significant" (DTTC Prehearing Br. 41) as China's interests, but this claim is specious. The SEC's interest in obtaining the requested documents for its investigations was based on the

[49] DTTC selectively quotes from *In re Sealed Case* to suggest that this Court "should not 'sit in judgment on the acts of the government of another done within its own territory.'" DTTC Prehearing Br. 40-41 (borrowing part of quotation from *Underhill v. Hernandez*, 168 U.S. 250, 252 (1987), involving act of state doctrine). But this is not correct, precisely because the nature of the sovereign interests must be balanced against each other. *See Société Nationale Industrielle Aérospatiale*, 482 U.S. at 544 n.29. To the extent a comity analysis is conducted at all in assessing, under Section 106(e) and Rule 102(e), a foreign firm's decision to choose foreign law over U.S. law, this ALJ and the Commission can and should consider the reasons behind a foreign sovereign's establishment of such foreign law.

legitimate national need to enforce the securities law. *See, e.g.*, *Gabelli v. SEC*, 133 S. Ct. 1216, 1222 (2013); *Alfadda v. Fenn*, 149 F.R.D. 28, 34 (S.D.NY 1993) ("[t]he United States has a strong national interest in the enforcement of its securities fraud laws"). The provisions of Sarbanes-Oxley itself, as well as the testimonies of the Division's 10 investigative personnel, the Division's expert Anthony Jordan, and even certain of Respondents' witnesses establish beyond any quibble that the Division had a very strong interest in receiving audit workpapers for its investigations involving potential accounting fraud. *See infra*, Argument Section III.B.3. Not one witness has suggested that the SEC was unharmed by not receiving the requested workpapers. The Division's interest now in seeking an appropriate remedy, including at least partial debarment of Respondents, "is not only justified in the instant case but required to preserve our vital national interest in maintaining the integrity of the securities markets against violations committed and/or aided and assisted by parties located abroad." *Banca Della Svizzera*, 92 F.R.D. at 112.

Although Respondents point to China's interests in (1) secrecy, and (2) "territorial sovereignty and core interests" (DTTC Prehearing Br. 41), both sets of interests deserve little or no deference. China's secrecy interest is undermined in the first instance by the extremely broad and malleable nature of the definition of a state secret – a point Respondents themselves have emphasized. *See* Tang Report ¶39 ("the scope [of the State Secret Law] is still broad under Chinese law"); Clarke Initial Report ¶19. Because of the sheer breadth of its secrecy laws, China has only a speculative interest in these laws. *See Munoz v. China Expert Tech.*, No. 07 Civ. 10531 (AKH), 2011 WL 5346323, at *1-2 (S.D.N.Y. Nov. 7, 2011) (China had only a "speculative" national interest in "state secrecy and other related laws [that] have broad sweep and can preclude disclosure of a host of nebulously defined categories of information").

Moreover, the record makes clear that secrecy was not truly the Chinese government's motivating concern. The alleged directives of the CSRC and MOF applied to Respondents regardless of whether the requested documents contained state secrets. *See* Tr. 1455:10-19 (Leung). To date, among all the documents sought by the SEC through the Requests, only very few have been determined to contain state secrets. *See* Tr. 1808:8-1809:12 (Chiu) (describing review for DTTC Client A). If the Chinese government's genuine concern in fact was improper dissemination of state secrets or other nationally sensitive information, it simply could have allowed its normal review processes at the SSB and the SAA to operate; instead the government (according to KPMG Huazhen) short-circuited these processes.

Finally, to the extent state secrets are actually identified among the documents, this still does not demonstrate a national interest that overrides the U.S. interests at stake here. Much or all of the information contained in the documents should be related to, or derivative of, information already publicly disclosed by the Clients through SEC filings, among other means. *See Munoz*, 2011 WL 5346323, at *2. Here, as in *Richmark*, there is "no indication that [Respondents or the customers of their Clients], much less the economy of the PRC as a whole, will be adversely affected at all by disclosure of this information." 959 F.2d at 1477. [50]

At bottom, China's secrecy interest appears essentially to collapse into its second interest, territorial sovereignty: a desire by the Chinese government to control access by foreign regulators to information within the country's borders, by channeling all requests through the CSRC. The insubstantial nature of this interest is confirmed by the CSRC's failure to create a

[50] In *Richmark*, the court of appeals observed that "the State Secrecy Bureau did not express interest in the confidentiality of this information prior to the litigation in question. Indeed, Beijing routinely disclosed information regarding its assets, inventory, bank accounts, and corporate structure to the general public, for example through a trade brochure, and to companies with whom it did business. The State Secrecy Bureau did not object to the *voluntary* disclosure of any of this information. It is only now, when disclosure will have adverse consequences for Beijing, that the PRC has asserted its interest in confidentiality." *Id.* at 1476.

viable and expeditious framework within which the SEC's investigative interests can be met. The sum total effect – a blockade against the SEC's ability to conduct investigations of China-based issuers, by preventing the SEC from obtaining the workpapers from China – is not, according to the Supreme Court, a legitimate interest. *See Société Nationale*, 482 U.S. at 544 n.29 (holding that a nation's statutes requiring confidentiality are "relevant to the court's particularized comity analysis only to the extent that its terms and its enforcement identify the nature of the sovereign interests in nondisclosure of specific kinds of material.").

2. The SEC Had No Alternative Means Of Obtaining Documents Sought By the Requests.

Relatedly, Respondents' willful noncompliance cannot be mitigated by comity considerations, because the SEC had no other way of obtaining all of the requested documents. Where "information cannot be *easily obtained* through alternative means," the factor "weighs in favor of disclosure." *Wultz*, 910 F. Supp. 2d at 558 (internal quotation omitted; emphasis in original).

Sarbanes-Oxley Section 106(f) gives the SEC the *option* of allowing a foreign firm to satisfy its duties under Section 106 by producing audit workpapers to foreign regulators. Contrary to Respondents' prior statements to the SEC, however, this provision plainly did not *require* the SEC to allow such alternative production.[51] Thus, Section 106(f) is irrelevant to any comity analysis, as the only salient question is whether alternative means were, in fact, realistically available. In addition, alternative channels that might have become available ***after*** the institution of these proceedings are also irrelevant. Any such channels (which do not

[51] Section 106(f) states: "Notwithstanding any other provisions of this section, the staff of the Commission or the [PCAOB] may allow a foreign public accounting firm that is subject to this section to meet production obligations under this section through alternate means, such as through foreign counterparts of the Commission or the [PCAOB]." 15 U.S.C. § 7216(f).

currently exist in any event, *see infra* Argument Section VI) have nothing to do with whether any Respondent willfully refused to comply with a Request when it was issued.

As the record clearly shows, the SEC had no alternative means of obtaining any of the documents sought through the Requests. There were no third parties from which the Commission could obtain all of the requested information—Respondents are the sole entities that possess all or substantially all of their audit workpapers and related information. Although for years the SEC had made extensive efforts to obtain audit workpapers (among other types of enforcement assistance) through the CSRC, those efforts were to no avail. Indeed, during the very timeframe in which the CSRC allegedly directed Respondents not to comply with the Requests, the CSRC refused to serve as an alternative conduit for the documents.

As a signatory to the IOSCO MMOU, the CSRC is required to provide the fullest assistance permissible under its laws to the SEC. Tr. 935:23-937:14 (Arevalo); Tafara Decl., Ex 1, MMOU ¶7 **(ENF 325)**. Notwithstanding this commitment, as of time these proceedings were instituted, in December 2012 – and, indeed, as of the start of the hearing in July 2013 – the CSRC was not a viable gateway for the SEC to obtain audit workpapers from inside China. As noted, for three years the CSRC refused to produce (and even today has refused to produce) the workpapers for DTTC's Client A, even though the CSRC had them in its possession. *See supra*, Statement of Facts Section IV.A. From 2009 through June 2013, of the 23 requests for assistance in connection with 18 different investigations the SEC had sent to the CSRC (including, for example, bank and corporate records as well as audit workpapers), the SEC received no meaningful assistance at all. Tr. 963:8-967:25 (Arevalo); *see supra*, Argument Section II.C.2.[52] The CSRC's assistance was so ineffective that in October 2011 the SEC

[52] In addition to the testimony of Alberto Arevalo, OIA's Chief of Chief of International Cooperation and Technical Assistance, during the hearing, detailed summaries of the SEC's efforts with respect to

withdrew its requests relating to 13 of the investigations, because, among other reasons, delay rendered the requested materials useless. Tr. 961:4-963:7; First Arevalo Decl. ¶27 **(ENF 326)**.

The SEC's particular experience trying to obtain the workpapers for DTTC's Client A illustrated the futility of any attempt by the SEC to rely on the CSRC. Rather than provide the workpapers that it had in its possession, the CSRC proffered myriad excuses for why it would not deliver them to the SEC. Tr. 974:11-974:17 ("[T]hey would give one explanation for why they could not deliver the audit work papers, and then some time would transpire and I would receive a different explanation as to why the CSRC could not deliver the audit work papers."); Summary Exhibit re CSRC Explanations **(ENF 275)**.

First, the CSRC asserted that issues of "supervisory cooperation" had to be resolved. SEC email (12/10/10) **(ENF 200)**; Tr. 948:6-951:3. The CSRC then stated that it would not assist with respect to DTTC Client A because it was not consulted during the company's registration, and "due to relevant regulations of the PRC." CSRC letter (5/26/11) **(ENF 246)**; Tr. 954:21-958:13. Next, the CSRC claimed that it lacked authority under Article 179 of the Securities Laws of China and, for the first time, invoked Regulation 29 and the need for screening for "national secrets." CSRC letter (6/28/11) **(ENF 248)**; Tr. 988:23-991:17.[53] Yet, later, the CSRC indicated that the IOSCO MMOU could be used as a "mechanism to deliver the audit workpapers." CSRC email, (11/6/12) **(ENF 270)**; Tr. 1039:13-1042:10.

Meanwhile, the SEC diligently tried to follow up with the CSRC. Between June 2010 and March 2013, the SEC participated in 54 communications with the CSRC (including three in-

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obtaining assistance from the CSRC under the IOSCO MMOU are contained in his declarations filed in *SEC v. Deloitte Touche Tohmatsu CPA Ltd.*, 11 mc512 (GK). *See* First Arevalo Decl. **(ENF 326)**; Second Arevalo Decl. **(ENF 327)**.

[53] Notably, in its application to the IOSCO MMOU, the CSRC indicated that any assertion of state secrets on its part for providing assistance to overseas authorities would apply only in very extreme situations. *See* Tr. 991:25-996:19 (Arevalo); SEC letter (7/5/11) **(ENF 212)**.

person meetings, but not including correspondence received) relating to requests for audit workpapers, 39 of which related specifically to the audit workpapers for DTTC Client A. *See* Summary Exhibit re SEC Communications **(ENF 274-A)**. Despite CSRC indications and SEC expectations that documents would be provided during a planned January 2012 meeting in Washington, *see* CSRC email (11/24/11) (**ENF 251**) ("[I]t is my wish that I can deliver something to you by the time when we visit in Washington."); Tr. 1000:7-1000:17 (Arevalo) ("Our office anticipated in that meeting of January 2012, when CSRC staff was coming to Washington, they would bring the requested audit work papers relating to Client A investigation."), the CSRC arrived without the documents, *see* Tr. 1002:4-1002:6.

In March 2012, the CSRC again held out the possibility that it might provide the audit workpapers, but only if the SEC signed a letter of consent preventing the SEC from using the documents for investigation or litigation purposes, CSRC email and attachment (3/30/12) (**ENF 253**); these conditions were "contrary to the standards of the MMOU" and would have made the documents "of no use to the SEC." Tr. 1006:2-1011:17. Then the CSRC asserted that it would not produce *all* of the work papers because (1) the SEC's request was not pursuant to a regular inspection of an audit firm, and (2) the CSRC had reviewed and made its own determination as to which workpapers the SEC needed. *See* CSRC-SEC Correspondence, 4/11/2012 (**ENF 256**); CSRC email (4/9/12) (**ENF 255**); Tr. 1019:21-1021:21, 1013:17-1016:10. Still today, the SEC has not received any production of the DTTC Client A workpapers. Tr. 65:22-65:24 (Josephs); 944:14-944:17 (Arevalo).

Given the length of time and amount of effort spent by SEC staff trying to obtain these documents, the SEC's OIA began to advise enforcement investigators that "it may not be worth their time and effort to make a request to the CSRC." Tr. 976:8-976:18 (Arevalo). Regardless,

the SEC made another similar request for audit workpapers via the CSRC in June 2011 relating to DTTC Client G. *See* CSRC letter (6/30/11) (**ENF 211**); Tr. 977:25-978:23. The CSRC has not responded to this request. Tr. 979:4-979:15.[54]

In *Banca Della*, the court rejected comity concerns in enforcing discovery requests against a Swiss company, observing that although the company had "regularly suggested . . . a variety of alternative means by which the SEC might proceed to seek the disclosure," these "proposals would only send the SEC on empty excursions, with little to show for them except more delay, more expense, more frustration, and possibly also, the inexorable operation of time bars against the claims by statutory limits for the assertion thereof." 92 F.R.D. at 113. So too here. Given the SEC's concerted but unsuccessful efforts to obtain the DTTC Client A work papers from the CSRC, any additional efforts to obtain the workpapers sought by the Requests, by seeking the assistance of the CSRC, would have been pointless. The Division's discretionary decision not to continue spinning its wheels in this fashion did not render Respondents' refusal to comply any less "willful."

3. Audit Workpapers Are Important To SEC Financial Fraud Investigations.

The importance of the requested documents to the 10 SEC investigations involving the Clients cannot be seriously disputed. *See* April 30 Order, at 15. ("In addition to combatting fraud in audit reports, Section 106(b) assists the Commission in carrying out its statutory role over auditors and combatting fraud generally."); Consolidated Opp. at 27-29. Audit workpapers are a critical source of substantive information for the Division staff when investigating potential financial misstatements that may have resulted in violations of the federal securities laws.

[54] DTTC's witnesses stated that, pursuant to the CSRC's newly developed procedures, DTTC has delivered the Client G workpapers to the CSRC for production to the SEC. *See* Tr. 1637:11-1637:23 (George); Tr. 1793:4-1793:8; 1813:2-1813:11 (Chiu). However, the CSRC has yet to provide them to the SEC. *See* Tr. 706:1 – 706:6 (Chang).

Jordan Initial Report ¶¶15-27.[55] Even Respondents' experts readily admit audit workpapers are extremely important to the Division's ability to investigate accounting and financial fraud. *See* Tr. 2679:21-25(Atkins); [redacted] [UNDER SEAL]

During the Hearing, the testimony of the Division's witnesses uniformly reinforced this point. They testified about both the need for the workpapers in their investigations and the harm to the investigations from Respondents' willful refusals to provide them. The underlying investigations were begun based largely on cursory public announcements by the issuers.[56] The Division's witnesses testified that they sought workpapers, which typically contain detailed information on the types of issues identified in those announcements, in order to determine whether there were legal violations and, if so, what individuals were responsible.[57] In addition, by reviewing the workpapers, the Division staff could also determine whether each Respondent carried out its responsibility as gatekeeper. Tr. 61:9-61:21 (Josephs); Tr. 281:1-283:4 (Peavler); Tr. 743:20-743:23 (Kazon); Tr. 865:11-865:20 (London); *see also*, Tr. 2679:21-2681:8 (Atkins); [redacted] [UNDER SEAL]. Without the workpapers, the Division has been

[55] Mr. Jordan's expert report was filed under seal because it contained opinions related to the Respondents' confidential business and financial information. However, the portions of his report cited in the text above are not in any way derived from this confidential information.

[56] *See* Tr. 54:22-54:25 (Josephs); DTTC Client A Form 6-K (6/3/10) (**ENF 125**); Tr. 168:1-168:10, 170:22-171:5 (Rana); Client E Form 8-K (4/1/11) (**ENF 71**); Tr. 365:25-369:21 (Kaiser); Client I Form 8-K, 11/16/2012 (**ENF 109**); Client I Form 8-K (3/1/11) (**ENF 110**); Client I Form 8-K (10/5/11) (**ENF 111**); Tr. 607:22-610:2 (Weinstein); Dahua Client A Form 8-K/A (3/16/10) (**ENF 36**); Tr. 695:2-696:1 (Chang); Client G Form 8-K (9/13/10) (**ENF 92**)), issues summarized in auditors' Section 10A letters (Tr. 269:5-269:14, 357:11-357:25 (Peavler); Client C EYHM 10A letter (9/22/11) (**ENF 54**); Tr. 476:20-479:7 (Hubbs); Client B EYHM 10A letter (3/15/11) (**ENF 45**); Tr. 788:13-788:22 (Boudreau); Client F KPMG 10A letter (4/20/11) (**ENF 83**)), or unsubstantiated Internet reports (Tr. 268:1-269:3 (Peavler); Client C Internet Report (**ENF 53**); Tr. 739:1-740:12 (Kazon); Client D Internet Report Sinclair Upton Research, 3/2011 (**ENF 64**); Client D Internet report Alfred Little (3/11) (**ENF 65**); Tr. 854:2-855:17 (London); Client H Internet Report (2/1/11) (**ENF 104**).

[57] Tr. 59:14-61:8 (Josephs); Tr. 191:9-191:16, 192:15 – 193:7 (Rana); Tr. 272:19-273:9 (Peavler); Tr. 370:8-370:22, 395:9-396:25 (Kaiser); Tr. 482:2-483:15, 573:2-573:17 (Hubbs); Tr. 616:8-617:12 (Weinstein); Tr. 698:23-699:10; 700:11-701:10; 734:4-734:9 (Chang); Tr. 743:9-743:20 (Kazon); Tr. 791:14-792:22 (Boudreau); Tr. 861:23-865:10 (London).

unable to advance or complete its investigations, as discussed below. *See infra*, Argument Section VI.A.2.

4. Respondents Willfully Courted Whatever Hardship They Would Have Faced In Producing The Requested Documents, And Fail to Show Any Likelihood of Criminal Liability from Such Productions

Respondents have claimed that, had they complied with the Requests, they would have been subject to potential civil and criminal sanctions. Whatever the risks that exist under Chinese law, Respondents knowingly accepted them by availing themselves of the U.S. securities markets. *See Richmark*, 959 F.2d at 1477; *Banca Della*, 92 F.R.D. at 117 (rejecting defendant's request to preclude discovery based on Swiss secrecy laws and observing that "[the defendant] invaded American securities markets and profited in some measure thereby. It cannot rely on Swiss nondisclosure law to shield this activity.").

Furthermore, Respondents fail to carry their burden in showing that they could not have produced at least *some* of the requested documents without incurring a non-speculative chance of criminal liability. *See Cochran Consulting, Inc. v. Uwatec USA, Inc.*, 102 F.3d 1224, 1227-28 (Fed. Cir. 1996) (court could consider whether "the non-producing party could *reasonably* incur foreign criminal liability" (emphasis added)); *Wultz v. Bank of China*, No. 11cv1266 (SAS), 2013 WL 1832186, at *4 (S.D.N.Y. May 1, 2013) ("*Wultz II*") ("[T]he party resisting discovery must provide the Court with information of sufficient particularity and specificity to allow the Court to determine whether the discovery sought is indeed prohibited by foreign law."). Respondents have not shown that they reasonably could have incurred criminal liability (1) under China's Archives Law, *see supra*, Argument II.D.1 & n.41; (2) under the alleged oral directives, Tr. 2426:5-2427:22 (Tang) (failing to identify any basis in Chinese law for criminal liability other than state secrecy and archives laws); Tr. 2541:3-2542:21 (Feinerman) (same); or

(3) for producing documents that were unlikely to contain state secrets, *see supra*, Argument Section II.D.1.[58]

5. Respondents Have Not Acted In Good Faith.

Finally, Respondents cannot make "an affirmative showing" that they have acted in good faith by their participation in U.S. markets and simultaneous refusal to produce the requested documents to the SEC. *Richmark*, 959 F.2d at 1479 (upholding contempt finding against Beijing where company "made no such affirmative showing" of good faith). Respondents' professed "inability to produce documents as a result of foreign law prohibitions" resulted from their own calculated business decisions before and after they received the Requests. *See Minpeco*, 116 F.R.D. at 522-23; *supra*, Argument Section II.A.

IV. RESPONDENTS' CLAIM OF REASONABLENESS DOES NOT MAKE THEIR CONDUCT LESS WILLFUL

Respondents contend that they acted with objective reasonableness because of legal uncertainty surrounding their obligations under Section 106; thus, they argue, they cannot be sanctioned even if these proceedings demonstrate that they incorrectly interpreted those obligations. *See* DTTC Prehearing Br. 42-44. This contention, however, cannot mitigate Respondents' liability for their willful refusals.

First, Respondents' claim is legally irrelevant. In *Safeco*, relied upon by DTTC (Prehearing Br. 43), the question whether the company's conduct was "objectively reasonable" was germane to liability only because the Supreme Court held that the civil liability provisions of the FRCA included reckless conduct. *See* 551 U.S. at 68-70. Applying the common law meaning of recklessness, the Court reasoned that the company could not be liable for objectively

[58] Even the alleged possible (non-criminal) sanction of license revocation is speculative. According to Respondents' witness, the CSRC and MOF made only the vague statement that "[i]n *most serious* case, it *could* be a cancellation of the license." Tr. 1432:21-22 (Leung) (emphasis added).

reasonable conduct under the FRCA. *See id.* Here, however, the question is whether Respondents' refusals to comply with the Requests were "willful" under the securities laws, a distinctly different inquiry. *See In the Matter of optionsXpress, Inc.*, ID Rel. No. 490, 2013 WL 2471113, at *62 n. 116 (Initial Decision, June 7, 2013) ("Willfulness does not require an intent to violate the law, nor does it require 'deliberate or reckless disregard of a regulatory requirement.'" (quoting *Jacob Wonsover*, Exchange Act Rel. 41123, 69 SEC Docket 694, 711 (Mar. 1, 1999), *aff'd Wonsover*, 205 F.3d 408); *Tricarico*, 1993 WL 183678, at *2 n.5 (recklessness unnecessary to a finding of willfulness).

Second, even judged under a recklessness standard, Respondents' conduct was not objectively reasonable. Respondents' obligations to produce documents to U.S. regulators upon demand under Sarbanes-Oxley did not present ambiguity. Indeed, from the time Respondents registered with the Board, the necessity for their compliance with these obligations was highlighted to them, and the Dodd-Frank Amendments served only to reinforce these obligations. Respondents could have declined to designate agents for the receipt of document demands under Section 106(d) and stopped engaging in U.S.-focused business. Instead, Respondents acknowledged their understanding of their obligations by designating U.S. agents under Section 106(d). *See* Tr. 1517:6-1517:23 (Leung). Whether or not a court or the SEC have "spoken on the issue" of Respondents' production obligations does not matter, because Respondents have acknowledged that they always understood those obligations.

Even assuming there was any ambiguity, SEC staff issued Wells notices to Respondents making clear that, notwithstanding Respondents' claims about constraints under Chinese law, they were obligated to produce documents to the SEC in response to the Requests, and their failure to do so would lead to these proceedings under Rule 102(e). Because Respondents were

"advised by members of the Commission's staff that [their] methods of conducting . . . business were unlawful," "[t]here is no room for doubt . . . that [Respondents'] violations were willful." *Hughes*, 174 F.2d at 976.

V. IMPOSITION OF A REMEDY WOULD NOT BE ARBITRARY AND CAPRICIOUS

There is nothing arbitrary and capricious in the Commission's attempts to seek a remedy for Respondents' willful conduct. Any analysis as to whether the Commission's action is consistent with the Administrative Procedures Act is a narrow one, in which a court's judgment cannot be substituted for that of the Commission. *Citizens to Preserve Overton Park, Inc. v.* Volpe, 401 U.S. 402, 417 (1971). Particularly given the Commission's duty to protect the public, "[a] [c]ourt ordinarily should not substitute its judgment of what would be appropriate under the circumstances in place of the Commission's judgment as to measures necessary to protect the public interest." *Pierce v. SEC*, 239 F.2d 160, 163 (9th Cir. 1956). The Commission's action here is consistent with its longstanding and well-articulated approach to protecting investors by sanctioning regulated entities for failing to satisfy their record keeping and production obligations.

A. That The SEC Has Allowed IPOs By Foreign Private Issuers Audited By These Respondents Is Irrelevant

Respondents assert that the Commission's institution of these proceedings is arbitrary and capricious because during the pendency of these proceedings, the Commission has not stopped China-based companies from entering the U.S. capital markets. Respondents' contention is that the Commission's stated goals of protecting investors and its processes are somehow belied by the Commission's failure to bar two China-based companies, LightintheBox Holding Co., Inc. and YY, Inc., from making recent offerings in the U.S. DTTC Prehearing Br. at 45-46. However, as an initial matter, there is nothing arbitrary and capricious about the Commission's

exercise of its prosecutorial discretion to institute these proceedings to protect its processes. This proceeding is fully consistent with the Commission's mission both to protect investors and to promote capital formation. *See infra* Argument Section VI. Further, the standards and procedures for instituting a Rule 102(e) proceeding are different than – and unrelated to – those governing the Commission's oversight of the registration requirements of the Securities Act of 1933. Whether certain companies met those Securities Act standards is simply irrelevant to the issues of whether the Commission properly instituted these proceedings or whether Respondents should be sanctioned here. Indeed, Respondents have not even tried to explain the legal basis for the Commission's authority to stop these (or similar) offerings from going forward, even assuming the Commission determined it was prudent to take such action.

First, as Respondents are surely aware, any attempts by the Commission to have blocked offerings of DTTC's client LightInTheBox Holding Co. and PwC Shanghai's client YY, Inc. would have needed to comport with the standards for review of registration statements as laid out in Section 8 of the Securities Act of 1933 – the adequacy of the information, the facility with which that information can be understood, and the public interest and protection of investors. Only if it is concluded that these standards have not been met can the Commission order an examination for issuance of a stop order under Section 8(e). In order to actually initiate a stop order proceeding to suspend the effectiveness of a registration statement, there must be some indication that the registration statement includes "any untrue statement of material fact or omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading." Section 8(d). There is no suggestion by Respondents that the referenced registration statements contained any untrue statements. Indeed, it would be odd for Respondents to make that assertion, given that two of them – DTTC and PwC Shanghai –

audited the financial statements and issued unqualified audit opinions which they consented to have included in the registration statements.

Second, what Respondents seem to be suggesting is that there should be a complete embargo of the U.S. capital markets to all of the following categories of companies: any China-based company, any company with operations in China, any issuers audited by Respondents, and any companies organized under the laws of a jurisdiction in which the Commission has not been able to obtain foreign audit firm's workpapers. Ironically, in essence, the Respondents are advocating that the Commission deregister their own audit clients, even as they assert in these proceedings that any remedy imposed by the Commission will have the unintended consequence of forcing their audit clients to delist their securities.

Basically, what Respondents are attempting again via this argument, and should not be permitted to do, is to shift blame to the regulators for their own conduct. If anything, Respondent DTTC's and PwC Shanghai's involvement in these registrations demonstrates their continuing willful behavior in participating in the audits of U.S. issuers while knowing that they will not provide their audit workpapers on demand.

B. The Commission May Both Seek Cooperation From Foreign Regulators And Seek Remedies Against Firms That Fail To Comply With The Securities Laws

There is nothing inconsistent here about the Commission's attempts to utilize the IOSCO MMOU to obtain audit work papers from the CSRC and yet hold registered auditing firms accountable for their statutory production obligations when the Commission's attempts have been unsuccessful. Indeed, the Commission has consistently sought to safeguard its oversight responsibilities by sanctioning regulated entities for failing to abide by their statutorily mandated

production obligations, including foreign regulated entities. *See supra* Argument Section I.A (discussing *Peak Wealth*, 2013 WL 812635; *Dominick & Dominick*, 1991 WL 294209).

Moreover, the Commission articulated its position that regulated entities must comply with their record keeping and production obligations, in its rejection of a Chinese rating agency's application for recognition as a Nationally Recognized Statistical Rating Agency. *See In the Matter of the Application of Dagong Global Credit Rating Co., Ltd.*, Exchange Act Release No. 62968, 99 S.E.C. Docket 141, 2010 WL 3696139 (Commission Order) (Sept. 22, 2010). In *Dagong*, the Commission found that it was "unable to conclude that Dagong can comply with the recordkeeping, production, and inspection requirements of the Exchange Act." *Id.* at *4.

Dagong is particularly relevant to the current proceedings because of Dagong's proposed solution that the Commission seek any document productions via the CSRC. As the Commission explained in rejecting that approach, "[W]e find that the process Dagong proposes for document production and inspection does not meet the requirements of Exchange Act Section 17(b) and related rules. As Dagong explained in its brief, the Commission staff must submit its document requests not to Dagong but to the CSRC, which would interpret the request, collect from Dagong those documents it deems responsive to the request, and remove any information that contains 'state secrets' before sending them to the staff." *Id.* at *4. While the Commission acknowledged "the critical importance of cooperation with non-U.S. financial regulators to achieve effective cross-border oversight and enforcement of securities laws," the Commission was unwilling to delegate its oversight responsibilities to the CSRC.

Here, respecting the importance the Commission places on cooperation with foreign regulators, the Division sought to work with the CSRC to obtain certain audit work papers. As laid out during the hearing and as described above, *see supra*, Argument Section II.C.2, these

efforts were unsuccessful. Attempting to hold Respondents accountable for their statutorily mandated production obligations under Section 106 is consistent with the Commission's exercise of its oversight responsibilities with respect to regulated entities and its refusal to delegate those responsibilities to a foreign regulator.

VI. RESPONDENTS SHOULD BE BARRED FROM ISSUING AUDIT REPORTS AND PERFORMING CERTAIN OTHER AUDIT SERVICES FOR U.S. ISSUERS

The Commission instituted these proceedings to "determine whether Respondents should be censured or denied the privilege of appearance and practice before the Commission for having willfully violated Section 106 of Sarbanes-Oxley." OIP ¶ 32. Respondents' violations of Section 106 satisfy all of the factors that the Commission considers when deciding whether to censure or debar accounting firms: they are egregious, recurrent, and willful; Respondents have made no assurances against future violations; Respondents refuse to acknowledge the wrongfulness of their conduct; and Respondents give every indication that they will continue to violate the same provisions of the securities laws unless the Commission imposes remedies that prevent them from doing so. These are more than adequate grounds for denying Respondents the privilege of appearance and practice before the Commission.

The Division respectfully requests that Respondents:

(1) be censured;

(2) be permanently barred from issuing audit reports filed with the Commission ("Principal Auditor Bar"); and

(3) be permanently barred from playing a 50% or greater role in the preparation or furnishing of an audit report filed with the Commission ("50% Role Bar").[59] The details of this proposed bar are explained below, *infra*, Argument Section VI.C.1.

[59] The Division refers to the Principal Auditor Bar and 50% Role Bar collectively as the "Proposed Bar."

The Division's proposed remedy directly addresses the harm caused to the Commission's processes by Respondents' willful violations of Sarbanes-Oxley. Respondents have performed audit work, issued audit reports, or played substantial roles in the preparation or furnishing of audit reports for the Clients and other issuers, and they apparently have every intention of continuing such audit work, notwithstanding the Commission's clear stance that such work violates the Act. Indeed, Respondents offered, in pretrial briefing, to stipulate that throughout these proceedings, they have "continued to take on engagements involving U.S. issuers." *Id.*[60] By willfully refusing to produce their audit workpapers in response to Section 106 requests, Respondents have effectively eliminated a central means for the SEC's oversight of their activities. By continuing to conduct audit work even while arguing that they are not bound by Section 106, Respondents demonstrate that they will continue to evade such oversight, and thereby undermine the U.S. securities market, until a court orders otherwise. The Division's Proposed Bar rectifies this harm by preventing Respondents from serving as the principal auditor, or *de facto* principal auditor, for issuers whose securities are traded in the U.S.

A. Debarment Is Justified By The Serious Harm To The Commission's Processes That The Respondents Have Caused Through Their Willful Violations

1. Legal Standard For Imposing 102(e) Remedies

The purpose of disciplinary measures ordered under 102(e) "is not to punish, but to protect the public." *In the Matter of Dohan & Co., CPA,* Initial Decision Release No. 420, 110 SEC Docket 1973, 2011 WL 2544473, at *16 (Jun. 27, 2011). In determining what remedial

[60] Moreover, in their motion to quash the Division's pre-hearing request for subpoena, the Respondents stated, "there is no reason for Respondents to cease all work for PRC-based issuers based on potential issues related to future requests for production." Respondents' Mot. to Quash Subpoena, at 9 (6/14/13). *But see* Tr. 2097:25-2098:9 (Feng) (claiming that Dahua is not currently performing audit work for U.S. issuers or taking new U.S. audit clients).

measures to impose against auditors who are liable under 102(e), the Commission typically focuses on the seriousness of the misconduct at issue. *See, e.g.*, *In the Matter of Gregory M. Dearlove, CPA*, 92 SEC Docket 1427, 2008 WL 281105, at *30 (Jan. 31, 2008); *In the Matter of James Thomas McCurdy, CPA*, 82 SEC Docket 282, 2004 WL 210606, at *9 (Feb. 4, 2004). In addition, the Commission may consider the so-called "*Steadman* factors":

> [1] the egregiousness of the defendant's actions, [2] the isolated or recurrent nature of the infraction, [3] the degree of scienter involved, [4] the sincerity of the defendant's assurances against future violations, [5] the defendant's recognition of the wrongful nature of his conduct, and [6] the likelihood that the defendant's occupation will present opportunities for future violations.

Steadman v. SEC, 603 F.2d 1126, 1140 (5th Cir. 1979). *See, e.g.*, *Peak Wealth*, 2013 WL 812635, at *8-11 (applying Steadman factors in Rule 102(e) proceeding against CPA); *Barry C. Scutillo, CPA*, 74 SEC Docket 1944, 2001 WL 461287, at *52 (May 3, 2001) (same).

2. Respondents' Willful Violations Justify Debarment

Respondents' willful refusals to provide documents requested under Section 106(b) of Sarbanes-Oxley are serious infractions that warrant a stringent remedy. Audit workpapers are extremely important to the Division's ability to investigate accounting and financial fraud. *See supra,* Argument Section III.B.3. Without them, the Division's investigations may be effectively blocked, as happened here. In particular, the staff may be unable to determine whether substantive fraud occurred at Respondents' Clients, and therefore unable to recommend substantive accounting fraud charges. Audit workpapers could also enable staff to determine whether Respondents' audit work for the Clients complied with applicable laws and professional standards. *See, e.g.*, Tr. 634:12-635:5 (Weinstein) (Division is unable to determine the adequacy of Dahua's testing of a material transaction listed on financial statements of Client A); Tr. 759:5-760:3 (Kazon) (Division "essentially put the investigation [of Client D] on hold" because it was

unable to investigate certain allegations that should be addressed in the audit workpapers of KPMG Huazhen); Tr. 392:18–394:11 (Kaiser) (Division was unable to investigate certain issues at Client I because PwC Shanghai withheld its audit workpapers). This may occur even where the auditor states, in either a 10A letter or a Form 8-K, that it believes illegal or improper conduct has occurred at an issuer.[61]

The lack of workpapers has also significantly delayed the Division's investigations, Tr. 74:8-22 (Josephs), which could prevent the Commission from obtaining penalties even where an issuer or auditor is ultimately found to have committed fraud. *See Gabelli*, 133 S. Ct. 1216. Finally, even where the Commission has filed substantive civil actions, the lack of workpapers limited the scope of the Commission's allegations. For example, in the Client C investigation, although the Commission filed an action against the issuer and its Chairman and executive officers, the staff could not adequately investigate or recommend certain potential charges because the Division lacked information that likely would have been included in the workpapers of its auditor, EYHM. *See* Tr. 280:13-282:2 (Peavler). *See also* Tr. 200:14-201:14 (Rana) (the Division was unable to investigate or prosecute certain alleged violations by Client E that were raised by KPMG Huazhen); Tr. 875:2-876:2 (London) (the Commission was forced to limit its charges against Client H and certain of its officers to market manipulation, because without PwC Shanghai's workpapers, staff lacked sufficient evidence to bring accounting-related charges).

In each of these investigations, Respondents' willful refusal to produce documents requested under Section 106 impeded the Commission's oversight of U.S. issuers and their

[61] *See, e.g.*, EYHM 10A Letter to Client B (**ENF 45**); Tr. 492:12-25, 572:22-573:17 (Hubbs) (Division was unable to investigate or prosecute alleged misconduct at Client B identified by EYHM in 10A letter); KPMG 10A Letter to Client F (**ENF 83**); Tr. 799:7-24 (Boudreau) (Division was unable to investigate or prosecute alleged misconduct at Client F identified by KPMG Huazhen in 10A letter); Client G 8-K describing circumstances of DTTC resignation (**ENF 92**); Tr. 708:22-709:8 (Chang) (Division was unable to investigate or prosecute alleged misconduct at Client G identified by DTTC in Form 8-K).

auditors. A bar is therefore necessary "to ensure that the Commission's processes continue to be protected, and that the investing public continues to have confidence in the integrity of the financial reporting process." *Dearlove*, 2008 WL 281105, at *30 (internal quotation omitted); *see also* April 30 Order, at 7 ("The purpose of Commission Rule 102(e)(1)(iii) is remedial and the rule is directed at protecting the integrity of the Commission's own processes and the confidence of the investing public in the integrity of the financial reporting process.") (citations and quotations omitted).

The *Steadman* test further confirms that Respondents' willful violations warrant a bar against practicing before the Commission, as each of the six *Steadman* factors weighs in favor of significant remedial measures:

> [1] Egregiousness. Respondents' willful violations are at least as egregious as other misconduct that has resulted in bars against accountants. In *Dearlove,* the Commission recognized that "a negligent auditor can do just as much harm to the Commission's processes as one who acts with an improper motive," and "that, under some circumstances, unreasonable conduct is not necessarily a less egregious disciplinary matter than either intentional or reckless conduct." 2008 WL 281105, at *30. Here, Respondents' willful conduct was egregious, among other reasons, because it caused extreme harm to the Commission's processes; as described above, it prevented the Commission from performing its basic oversight of auditors and issuers. *See Peak Wealth*, 2013 WL 812635 (imposing total bar against accountant for conduct including failure to produce documents).
>
> [2] Recurrence. Respondents' willful violations were recurrent. Four of the five Respondents committed their violations on multiple engagements at issue in these

proceedings. There is no suggestion that, had the SEC sent additional Section 106 requests to Respondents in connection with other investigations, the result would have been any different.

[3] Scienter. Respondents acted willfully, by purposefully participating in U.S. markets despite the belief that Chinese law could impair their compliance with U.S. rules, and then by consciously refusing to produce documents. *See supra*, Argument Section II. Such willful conduct is more than sufficient to justify a bar.

[4] Assurances against future violations. Respondents make no assurances against future violations of Section 106. To the contrary, they continue to take on audit engagements with U.S. issuers that could directly lead to future violations of this provision.

[5] Acknowledgment of "wrongful nature of [their] conduct." Respondents, of course, do not make such an acknowledgment. Rather, they continue to argue that they did not violate the law and acted only in good faith. *See supra*, Argument Section I.C.

[6] Likelihood of opportunities for future violations. The likelihood is very high. Respondents effectively argue that they should be allowed to continue to profit from U.S. markets while refusing to produce workpapers requested under Section 106, and they see "no reason . . . to cease all work for PRC-based issuers based on potential issues related to future requests for production." Only a bar against practicing before the Commission will prevent the near certainty of future violations by some or all of these Respondents.

In summary, each of the six *Steadman* factors weighs strongly against Respondents.

Censure and the Proposed Bar against practicing or appearing before the Commission in certain key roles are therefore appropriate remedies.

3. The Proposed Bar Is Not Unfair, Regardless Of Chinese Law

Even assuming that Chinese law or directives impaired Respondents' abilities to comply with the Section 106 Requests, debarment is still justified. The harms caused by Respondents' willful violations exist independently of Chinese law, and they result from Respondents' decisions to insert themselves into U.S. markets while purporting unilaterally to exempt themselves from compliance with the U.S. securities laws. Respondents remain accountable for their own choices. They alone are responsible for the decisions that culminated in their willful violations: (1) registering with the PCAOB; (2) designating agents for receipt of Section 106 Requests, as required after Dodd-Frank; and (3) performing audit work for issuers of securities traded on U.S. markets. Moreover, Respondents have chosen to violate U.S. law rather than violate Chinese law. The Division does not argue that Respondents should have chosen to violate Chinese law, nor does the Division now seek to compel Respondents to do so. The Division seeks only to prevent Respondents from continuing their willful violations of U.S. law in a manner that impedes the SEC's oversight of U.S. markets.

Respondents claim that *any* sanctions against them "would be fundamentally unfair and inappropriate." KPMG Br. at 16. But it is not unfair to require Respondents to abide by the same disclosure obligations to which their peer audit firms around the world are subject; indeed, it would be unfair to exempt them from those obligations. Respondents' citations of other audit firms' PCAOB Form 1s **(RX 309-364)**, and of the recent registrations of certain Chinese issuers' securities with the Commission **(RX 249; 252-255; 260; 262-265)**, are red herrings. This proceeding and the Division's proposed remedy were not triggered by Respondents' withholding of consents on PCAOB Forms 1 and 2; they are based on Respondents' willful refusals to

produce documents requested pursuant to Section 106(b). Any implication that the Commission has unfairly singled out Respondents while allowing other auditors that have withheld consents on PCAOB filings misses the point of these proceedings entirely. Similarly irrelevant are the registrations of certain Chinese issuers. First, as this ALJ has observed, the relevant provisions of the securities laws do not grant the Division of Corporation Finance the authority to deny registrants' applications solely on the basis of prospective registrants' locations. *See* Prehearing Conf. Tr. 44:25-45:17; *see supra*, Argument Section V.A. Moreover, Respondents fail to explain why the Division should take remedial action against *issuers* for *Respondents'* willful violations.

Respondents complain that they relied on past Commission practices in building their U.S. auditing practices. *See* KPMG Pretrial Brief, at 2. According to this theory, because the Commission has at times negotiated various MOUs and (until now) permitted Respondents to practice before it, the Commission's current effort to protect its own processes is unfair, and constitutes an arbitrary and capricious violation of Respondents' reliance interest in their ability to practice before the Commission. But this proceeding is not arbitrary and capricious, *see supra*, Argument Section V, and Respondents' contention that "the Commission itself assumed certain risks by (and obtained benefits from) permitting China-based accounting firms to register with the PCAOB" (KPMG Prehearing Br. 25) has it exactly backward. Respondents' decisions to incur costs in building their U.S. practices constituted a calculated gamble; it should not fall on the Commission or investors to insulate Respondents from the downside of that gamble, any more than the Commission or investors were entitled to reap the benefits of that gamble, in the form of the millions of dollars in audit fees that Respondents have earned as a result. Respondents' business strategies are their own responsibility.

4. The PCAOB's Recent Memorandum of Understanding With The CSRC Does Not Merit A Lighter Sanction

Respondents contend that the SEC should resolve this impasse through continued negotiations with the CSRC, and/or by following existing inter-governmental procedures to obtain workpapers from Respondents. This argument fails for many reasons. First, none of the potential alternative procedures cited by Respondents would mitigate Respondents' obligations, under Section 106, to provide workpapers directly to the Commission upon request. Second, the SEC already engaged in years of effort to work with the CSRC under the IOSCO MMOU, to no avail; the CSRC is not now a dependable conduit for workpapers, if indeed it is even a viable conduit.[62] In any event, the need remains to remedy Respondents' violations and make clear that future recipients of Section 106 requests must comply with them. Respondents' violations have impeded the Division's investigations and harmed the Commission's processes for years. Third, the recent MOU between the CSRC and PCAOB is irrelevant. By claiming that this MOU provides the *Commission* with an alternative means of obtaining workpapers, Respondents imply that the SEC should effectively cede to the PCAOB its authority to make Section 106 demands.[63] Even if such an approach were appropriate as a statutory matter – and it is not – it would not provide a practical solution. The PCAOB's sole focus is on the conduct of auditors, while the Commission oversees auditors in the course of its broader supervision of issuers and securities markets. Similarly, the PCAOB issues ABDs only in connection with its own investigations, and

[62] On the eve of the hearing in this proceeding, the Chinese government announced that it would provide certain workpapers to the Commission. The CSRC subsequently provided certain materials to the Commission, which may or may not satisfy the production obligations of the audit firm responsible for those workpapers. That production, which was unrelated to the ten investigations at issue here, and occurred only after the filing of a civil subpoena enforcement action, does not demonstrate viable "alternative means."

[63] Respondents also assume, without evidence, that the PCAOB MOU will prove effective, notwithstanding that the Commission's existing agreements with the Chinese government have not yielded meaningful cooperation.

not specifically to advance the Commission's investigations. As a consequence of its limited focus, and of the fact that the Commission and Board are, as an operational matter, independent of one another, there is no reason to believe that the PCAOB will always have investigations open into the same audits and auditors that the SEC is investigating. Moreover, the approach would add needless inefficiencies to a process that is already quite protracted, as this proceeding has demonstrated. In any event, Respondents have no legal basis for insisting that the SEC delegate this aspect of its investigatory authority to the PCAOB.

In short, there is nothing unfair about the Division's effort, through these proceedings, to prevent Respondents from continuing to willfully violate U.S. law and impede the SEC's oversight of U.S. markets, and Respondents have offered no evidence that the Division has any viable means, other than the Proposed Bar, of remedying Respondents' misconduct.

B. The Division's Proposed Bar Is Authorized Under Rule 102(e)

Rule 102(e)(iii) provides, "The Commission may censure a person or deny, temporarily or permanently, the privilege of appearing or practicing before it in any way to any person who is found by the Commission . . . [t]o have willfully violated . . . any provision of the Federal securities laws or the rules and regulations thereunder." 17 C.F.R. § 201.102(e)(iii). The Division's proposed bar is authorized under Rule 102(e), as the activities covered by the bar constitute "practicing before the Commission." Rule 102(f) provides that for accountants, "practicing before the Commission" includes "[t]he preparation of any statement, opinion or other paper . . . filed with the Commission in any registration statement, notification, application, report or other document with the consent of" the accountant. 17 C.F.R. § 201.102(f)(2). This definition unquestionably encompasses the Principal Auditor Bar, which prevents Respondents from issuing audit reports filed with the Commission. The conduct prohibited by the 50% Role Bar also constitutes "practicing before the Commission." The Commission has held that

"practicing before the Commission includes computing the figures and supplying the data incorporated into Commission filings and consenting to their incorporation." *In the Matter of Robert W. Armstrong, III*, 85 S.E.C. Docket 2321, 2005 WL 1498425, at *11 (Jun. 24, 2005). Thus, "an individual may . . . be found to have practiced before the Commission if he or she participated in the preparation of financial statements filed with the Commission by, for example, creating, compiling or editing information or data incorporated into" filings. *SEC v. Prince*, 2013 WL 1831841, at *36 (D.D.C. May 2, 2013) (quoting *SEC v. Brown*, 878 F. Supp. 2d 109, 125 (D.D.C. 2012)). The conduct that would be subject to the 50% Role Bar plainly meets this definition of "practicing before the Commission." *See* KPMG Br. at 27. The Division's proposed remedy is therefore authorized under Rule 102(e).

C. The Proposed Bar Is Appropriately Tailored

As commanded by Rule 102(e), the Division's Proposed Bar is prophylactic rather than punitive, designed to protect the public from Respondents' willful violations in a way that avoids unnecessary collateral effects on third parties, benefits markets and investors overall, and does not cause Respondents undue harm.

First, the Proposed Bar would address the most severe harms caused by Respondents' willful violations, and would prevent Respondents from causing the same harms to the Commission's processes in the future. By barring Respondents from signing audit opinions, the Proposed Bar would maintain the integrity of the reporting process that is the cornerstone of U.S. securities markets. No auditor should be allowed to attest to the validity of an issuer's financial statements without being willing to document that attestation. Similarly, the 50% Bar prevents Respondents from performing the majority of audit work underlying any audit opinion filed with the Commission, and shields investors from relying on such opinions. In light of Respondents' insistence that, absent a change of circumstances beyond their control, they will continue

indefinitely their violations of the law, the Proposed Bar is rationally related to Respondents' ongoing violations. It is therefore simply not true that the Proposed Bar "would not have any remedial effect." KPMG Prehearing Br. 31.

Second, the Proposed Bar is tailored to limit collateral effects on other market participants. With respect to PRC-based issuers of securities that either currently are, or in the future may be, registered and traded in the U.S., the Proposed Bar does not preclude them from registration and trading in the U.S. Respondents contend that PRC-based issuers could be forced to leave U.S. markets if they cannot hire Respondents as their auditors. KPMG Huazhen Pre-Hearing Br. at 29-31; Expert Report of Laura Simmons ¶ 45 (filed 7/1/13) ("Simmons Initial Report"). However, as an initial matter, the Proposed Bar would only affect clients for which Respondents either sign audit opinions or act in a 50% role. Respondents' own public filings with, [redacted], the PCAOB show that from 2010 through 2012, such engagements involved [redacted] in any given year. *See* Jordan Initial Report, at 18 [UNDER SEAL]. At the same time, [redacted]. *Id.* [UNDER SEAL] Thus, the Proposed Bar would have affected [redacted] of the issuers that Respondents were already servicing – quite apart from PRC-based U.S. issuers already using other auditors.[64] The Proposed Bar would not have affected the remaining population of issuers who engaged the Respondents.

Furthermore, even those approximately [redacted] of Respondents' issuer clients that would have been affected by the Proposed Bar would not necessarily be forced to de-list from U.S.

[64] Even if we view all issuers for which Respondents worked in a 20% or greater role as potentially affected, [redacted]. Jordan Initial Report, at 18 [SEAL]; Tr. 12:25-13:15 (Jordan) [UNDER SEAL].

exchanges. If the Proposed Bar is ordered, then such issuers may engage new auditors; [redacted], *see* Expert Rebuttal Report of Laura Simmons ¶ 15 (filed 7/19/13) ("Simmons Rebuttal") [UNDER SEAL] [redacted], and auditors located outside mainland China can and do perform audit work for PRC-based US issuers.[65] [redacted]. Expert Rebuttal Report of Anthony Jordan, at ¶ 15 (filed 7/19/13) [redacted] ("Jordan Rebuttal Report") [UNDER SEAL]; Tr. 88:6-91:4, 108:5-24 (Simmons) (same) [UNDER SEAL]. Thus, any attempt to estimate the likely number of affected issuers that would de-list, either by choice or because they were unable to find replacement auditors, is highly speculative. [redacted]. *See* Jordan Rebuttal Report, ¶ 6 [redacted] [UNDER SEAL]; Tr. 94:2-97:21 (Simmons) [UNDER SEAL]. And at any rate, [redacted] – to say nothing of the overall population of PRC-based US issuers – would not face this situation.

Most important, the Proposed Bar would protect investors. Respondents' expert estimates that if the Proposed Bar is imposed, the "likely consequences" to investors would

[65] *See* Tr. 2200:22-2202:25 (J. Wong) (KPMG Hong Kong performs audit work in mainland China pursuant to a temporary license that allows audit work for five years and an unlimited number of audit clientS). *See also* Tr. 187:8-192:7 (Rana) (Division received workpapers from US-based auditors of Client E); Tr. 479:21-480:22 (Hubbs) (Division received workpapers from US-based auditor of Client B); Tr. 698:18-700:10 (Chang) (Division received workpapers from US-based auditor of Client G).

include [redacted]. Simmons Rebuttal, ¶ 45 [UNDER SEAL]. This [redacted]," however, derives from a remarkably weak methodological approach. To begin with, [redacted]. Tr. 95:10-95:14 (Simmons) [redacted] [UNDER SEAL]. But even the author of the report that announced this decline conceded that [redacted]. *Id.* 95:21-23 ([redacted]) [UNDER SEAL]. Among other things, that scenario, in which issuers are "unable to engage [new auditors] quickly enough to file timely financial statements," Simmons Initial Report ¶ 45, ignores the provisions of the securities laws that permit registrants to delay filing required reports where circumstances prevent them from filing by the statutory deadlines. *See* Exchange Act Rule 12b-25, 17 C.F.R. § 240.12b-25. The listing rules of major U.S. exchanges include similar provisions. *See, e.g.*, NASDAQ Rule 5810(c)(2)(A)(iii),(iv) (listed companies have either 45 or 60 days to submit, to NASDAQ staff, plans outlining the companies' efforts to regain compliance with listing requirements of registered auditor or timely SEC reports, respectively).[66] And in fact, Respondents' failure to provide any estimate of the likelihood that Respondents' issuer clients would delist necessarily prevents them from offering

[66] [redacted] Tr. 97:8-21 (Simmons) [UNDER SEAL]. But the loss of an auditor due to the Proposed Bar (rather than due to resignation or termination by the issuer) satisfies the conditions under which extensions are permitted, and recent practice confirms the likelihood that the Commission would at least entertain applications for extensions under such circumstances. For example, on April 29, 2013, Herbalife Ltd. filed with the Commission a Form 12b-25 announcing that, due to the resignation of its auditor KPMG LLP for reasons unrelated to the condition of Herbalife, a number of Herbalife's previous filings could no longer be relied upon, and the company was therefore out of compliance with its filing obligations. Although, as of August 19, 2013, Herbalife remained out of compliance, its securities continued to be registered with the Commission and listed on the New York Stock Exchange.

a guess as to the probability that investors in Respondents' potentially-affected clients would experience any meaningful losses, *see* Simmons Initial Report, *passim* [UNDER SEAL]; [redacted] [UNDER SEAL].

In addition, even if all of Respondents' affected clients were to delist as a result of the Proposed bar – [redacted] – Respondents have vastly inflated the probable effects on their stock prices. Respondents project that affected securities listed on the NASDAQ would experience price declines of 19%, and those listed on the NYSE would decline by 50%. Simmons Initial Report at ¶ 45. As explained by the Division's expert, however, the studies on which Respondents rely for their projections are factually inapposite to the present situation, as those studies primarily address involuntary delistings caused by issuers' economic or financial distress. Expert Report of Chyhe Becker ¶¶ 9, 30-33 (filed 7/19/13) ("Becker Report"). Additional economic research indicates that the circumstances of an issuers' delisting have a significant impact on its stock-price effects, and further show that in circumstances most comparable to the Proposed Bar, the magnitude of stock-price decline associated with delisting ranges from -10% to -0.85%. *Id.* at ¶¶ 34-37. Furthermore, while Respondents' cited studies involve U.S.-based issuers listed only on U.S. exchanges, research addressing overseas issuers that are cross-listed in the U.S. – a population that is much more representative of those potentially affected by the Proposed Bar – demonstrates far milder stock-price effects from delisting. *Id.* at 38. *See also* Tr. 2586: 7-2587:23 (Chyhe Becker Testimony). [redacted]

[redacted]. Jordan Rebuttal Report ¶ 22 [UNDER SEAL].

Finally, in addition to vastly overstating the potential costs of the Proposed Bar, [redacted]. *See* Tr. 98:8-100:7 (Simmons) [UNDER SEAL]. Respondents have given every indication that absent the Proposed Bar, they will continue to perform audit work while disregarding the Commission's lawful requests for workpapers, reaping the considerable financial benefits that accrue to participants in U.S. markets even as they avoid accountability to the SEC and U.S. investors. Such a situation is unacceptable as a matter of principle, and would harm all U.S. investors in practice. In principle, Respondents, like all other U.S. market participants, must obey U.S. securities laws, rules, and regulations. As a practical matter, failure to require such compliance could have detrimental effects on U.S. markets. Substantial economic research shows that rigorous enforcement of disclosure obligations results in stronger markets, including higher stock prices. Becker Report, ¶¶ 7-8, 16-29. Consequently, all issuers listed on U.S. exchanges – including affected clients of Respondents who find replacement auditors – would benefit from the Proposed Bar.

Meanwhile, the Proposed Bar likely would cause only limited economic loss to Respondents. Respondents' [redacted]. Jordan Initial Report, at 18 [UNDER SEAL]; Tr. 8:14-12:24 (Jordan) [UNDER SEAL] [redacted].

[redacted]

[redacted] *Id.* at 13:16-17:1 [UNDER SEAL]; Jordan Rebuttal Report ¶¶ 24-28 [UNDER SEAL].

In sum, the Proposed Bar's costs are limited, and its benefits are substantial. The Commission's mission is to protect investors, ensure that U.S. markets are fair and efficient, and encourage capital formation. By enforcing the Act's disclosure obligations, enhancing confidence in the veracity of financial statements, and requiring all participants in the U.S. securities market to abide by the law, the Proposed Bar would further all aspects of that mission.

CONCLUSION

For the foregoing reasons, and in light of the record as a whole, the Court should find that that Respondents willfully violated Sarbanes-Oxley Section 106, and should impose the Division's remedy outlined above.

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Respectfully submitted,

David Mendel

David Mendel (202) 551-4418
Amy Friedman (202) 551-4520
Douglas Gordimer (202) 551-4891
Marc E. Johnson (202) 551-4499
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-5971

COUNSEL FOR DIVISION OF ENFORCEMENT

[67] [redacted]