ADMINISTRATIVE PROCEEDING
FILE NOS. 3-14872, 3-15116

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

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 Accountants Ltd.;
PricewaterhouseCoopers Zhong Tian CPAs Limited

Respondents.

The Honorable Cameron Elliot,
Administrative Law Judge

RESPONDENTS' POST-HEARING BRIEF

Date: August 30, 2013

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Respondents Dahua CPA Co., Ltd. ("Dahua"), Ernst & Young Hua Ming LLP ("EYHM"), KPMG Huazhen (Special General Partnership) ("KPMG Huazhen"), Deloitte Touche Tohmatsu CPA Ltd. ("DTTC"), and PricewaterhouseCoopers Zhong Tian CPAs Limited Company ("PwC Shanghai") respectfully submit this post-hearing brief pursuant to Rule 340 of the U.S. Securities and Exchange Commission (the "SEC" or "Commission") Rules of Practice, 17 C.F.R. § 201.340, and the August 1, 2013 Post-Hearing Order.[1]

I. INTRODUCTION AND SUMMARY OF ARGUMENT

In this disciplinary proceeding, the Division of Enforcement (the "Division") seeks a permanent bar against the major audit firms from an entire country, simply because those firms followed the law and directives of their home country, under circumstances where they had no choice to do otherwise. This unprecedented use of a disciplinary proceeding is inconsistent with the legislation on which the Division relies and is not supported by any of the evidence presented at the hearing.

The sole basis for this proceeding is Respondents' alleged violation of a provision of the securities laws, Section 106 of the Sarbanes-Oxley Act of 2002 ("SOX") as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). But Congress was very careful within that same section to define narrowly what could be "deemed a violation of this Act." In particular, Congress adopted a formulation found nowhere else in the securities laws and only rarely anywhere else in the U.S. Code: Congress provided that only a "willful refusal" to comply with a request for documents could constitute a violation. Congress

[1] Respondents hereby incorporate by reference their pre-hearing briefs, filed on June 24, 2013. Rather than repeating the background facts set forth in the pre-hearing briefs, or offering separate findings of fact as to each Respondent, this post-hearing brief will address evidence introduced during the hearing that most directly bears on the legal issues presented. Respondents are submitting this post-hearing brief jointly in an effort to avoid duplication and assist the Court in the most efficient manner possible, but do so explicitly reserving their rights to file individual reply briefs, if necessary, in order to address any particular individual issues raised in the Division's post-hearing brief.

unmistakably was aware of and respectful of possible conflicts of laws. In fact, the Dodd-Frank amendments evidence a clear intent to support efforts by U.S. regulators to address those potential conflicts through cooperation with foreign regulators, not to establish a regime that punishes foreign accounting firms for good faith compliance with their home country laws. Against this backdrop, the Division's case fails both on the law and the facts.

As to the law, the Division continues to argue for a construction of "willful refusal" in Section 106(e) that would equate it with "refusal" standing alone. This construction would violate fundamental principles of statutory construction, as well as the plain language, structure, and purpose of Section 106. The Division does not, and cannot, explain how Congress' conjunction of "willful" with "refusal" can be ignored.

As explained in DTTC's pre-hearing brief, the combination of "willful" and "refusal" is unusual, and it must be given meaning. Neither word can be rendered superfluous. *See Bailey v. United States*, 516 U.S. 137, 146 (1995). But the Division's reading of "willful refusal" would do just that, by ignoring that in Section 106, Congress paired the term "willful" with an act, "refusal," that already requires knowing and intentional conduct. *United States v. Seigel*, 168 F.2d 143, 147 (D.C. Cir. 1948) (contrasting a "refusal" with an "inadvertent failure").

Indeed, the Division's construction would completely read out the entirety of Section 106(e). Absent Section 106(e), any failure to produce documents would be a violation of the securities laws since it would violate Section 106(b)'s command that foreign accounting firms "shall" produce documents upon request. *See* 15 U.S.C. § 7216(b). And a "willful" failure to produce documents would then suffice as a basis for a Rule 102(e)(1)(iii) proceeding. 17 C.F.R. § 201.102(e)(1)(iii) ("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 ... to have *willfully violated* ... any provision of the Federal securities laws" (emphasis added)). But Section 106(e) on its face and as a matter of statutory construction requires more, by providing that only a "willful refusal" will be "deemed a violation." For Section 106(e) to serve any purpose at all, the term "willful refusal" must mean more than mere "willful" failure.[2]

As demonstrated below, none of the authority identified by the Division or during the hearing saves its construction of "willful refusal." To the contrary, all of these authorities demonstrate the uniqueness of the standard in the federal securities laws, and compel a construction that is more than mere "intent to do the act which constitutes a violation of the law."[3] ENF Pre-Hearing Brief at 30, 31, 34; *see In the Matter of Peak Wealth Opportunities, LLC*, Exchange Act Rel. No. 69036, Admin. Proc. 3-14979, 2013 WL 812635, at *5-8 (ALJ Order Mar. 5, 2013) (considering the term "willful" standing alone). The Division's position also flies in the face of the structure and legislative history of Dodd-Frank, which demonstrates that when Congress amended Section 106, it did so in a manner respectful of foreign laws and to facilitate coordination between U.S. and foreign regulators. Far from riding roughshod over foreign laws, as the Division would have the Commission do here, Congress accommodated principles of comity by providing that only a "willful refusal" to comply can be "deemed a violation of the Act."

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[2] To be sure, the Division seizes on just one of many constructions that courts have given to the term "willful." The U.S. Supreme Court and D.C. Circuit have repeatedly admonished that the word "willful" is a chameleon that takes on different meanings depending on context. *See, e.g.*, *Ratzlaf v. United States*, 510 U.S. 135, 141 (1994) ("'Willful,' this Court has recognized, is a 'word of many meanings,' and 'its construction [is] often . . . influenced by its context.'") (quoting *Spies v. United States*, 317 U.S. 492, 497 (1943) (alteration in original)). Indeed, in many contexts, the term "willful" itself—standing alone and not as part of a "willful refusal" formulation—has been construed to require proof of bad motive. *See, e.g.*, *Ratzlaf*, 510 U.S. at 137 ("To establish that a defendant 'willfully violated' the antistructuring law, the Government must prove that the defendant acted with knowledge that his conduct was unlawful."); *Bryan v. United States*, 524 U.S. 184, 191 (1998) (holding that the term "willful" in the Firearms Owners' Protection Act requires proof of "bad purpose").

[3] In any event, applying that standard to Section 106(e) would be circular, since here the "act which constitutes the violation of law" is itself defined as a "*willful* refusal."

The Division argues nonetheless that there are public policy purposes for its contrary construction of "willful refusal," but that is an argument for Congress. Absent further Congressional action, the Division's position runs directly contrary to the principle of prescriptive comity, which requires courts to construe statutes to "avoid unreasonable interference with the sovereign authority of other nations." *F. Hoffmann-La Roche Ltd. v. Empagran, S.A.*, 542 U.S. 155, 164 (2004); *see also In re Sealed Case*, 825 F.2d 494, 498-99 (D.C. Cir. 1987) ("A decision whether to enter a contempt order in cases like this one raises grave difficulties for courts. We have little doubt, for example, that our government and our people would be affronted if a foreign court tried to compel someone to violate our laws within our borders. The legal expression of this widespread sentiment is found in basic principles of international comity.")

For all these reasons, the "willful refusal" standard requires proof of bad intent or bad faith, which has not been and cannot be demonstrated here. *See* DTTC's Pre-Hearing Brief at 17-23; *Fed. Power Comm'n v. Metro. Edison Co.*, 304 U.S. 375, 387 (1938) ("[t]he qualification that the refusal must be 'willful' fully protects one whose refusal is made in good faith"); *see also Societe Internationale pour Participations Industrielles et Commerciales v. Rogers*, 357 U.S. 197, 211-212 (1958) (good faith inability to comply with discovery demands due to prohibitions of foreign law precludes sanctions).

The Division's suggestion that this Court should stretch the "willful refusal" standard beyond its Congressional intent is particularly inappropriate where, as here, the Division is trying to use Section 106 in an unprecedented manner, to disbar the vast bulk of the auditing profession from an entire country through Rule 102(e) proceedings. As the evidence at the hearing demonstrated, there is a large risk, if not a certainty, that such disbarment would cause the

delisting of a huge number of Chinese issuers, with a multibillion dollar impact on U.S. investors (the experts can debate about how many billions, but it is indisputably a large impact). Such drastic action should not be taken unless Congressional intent is crystal clear, and here the language, structure, and legislative history are all to the contrary.

Further, contrary to the Division's suggestion, the SEC is not lacking in recourse simply because there is no statutory basis for disciplinary action here. First and foremost, the SEC can, and should, embrace the new procedures recently adopted by the China Securities Regulatory Commission ("CSRC"), which already have resulted in the production of the Longtop workpapers and should soon result in the production of the workpapers that have been requested of the CSRC by U.S. regulators and are at issue in this proceeding. Indeed, as proposed in correspondence from several Commission Staff members to the CSRC, the production of requested documents should moot this proceeding. *See, e.g.*, Respondents Ex. 638. Moreover, there is nothing extraordinary about a production process that involves regulator-to-regulator production in lieu of direct production to foreign regulators. This is how the SEC and other U.S. regulators often obtain materials from foreign entities. Such a process respects the sovereign interests of foreign regulators and is well established.

Second, the SEC remains free to engage in rule-making or other regulatory action to address prospectively and comprehensively any remaining concerns about its ability to obtain workpapers from China (or other jurisdictions). In fact, this is exactly what the PCAOB has done—prospectively prohibiting new registrations from Chinese firms but allowing currently registered firms to continue,[4] and entering into its Memorandum of Understanding ("MOU") on Enforcement Cooperation with the CSRC and the China Ministry of Finance ("MOF") (through

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[4] Respondents Ex. 607 (Consideration of Registration Applications from Public Accounting Firms in Non-U.S. Jurisdictions Where There Are Unresolved Obstacles to PCAOB Inspections (Oct. 7, 2010)).

which it notably can obtain workpapers and share them with the SEC). Respondents Ex. 274. For all these reasons, the Division's construction of "willful refusal" is unsustainable.

As to the facts, the Division has failed to sustain its burden, including failing to show that Respondents have acted in bad faith or otherwise willfully refused to comply. *See* ENF Pre-Hearing Brief at 50-52. Contrary to the Division's prediction, the evidence at the hearing established beyond any doubt that Respondents are prohibited by Chinese law and the explicit instructions of their Chinese regulators from producing any of the requested documents directly to the SEC. Moreover, the evidence is absolutely clear that the production requested by the Division would have exposed Respondents to *criminal* sanctions. Indeed, a number of sets of workpapers have gone through the new CSRC screening and production processes—which have been approved at the highest levels of the Chinese government—and they have been found in fact to contain state secrets, meaning there would have been criminal consequences to providing them to the Division.

Respondents are not responsible for the legal impediments they currently face, or the severe attendant consequences that would result from violating those impediments, and have made substantial efforts to facilitate a production of the requested documents. There can be no finding of "willful refusal" in these circumstances.[5]

The hearing also established that the facts on numerous other issues demonstrate that the "willful refusal" standard has not been satisfied. First, all parties involved, including the SEC, PCAOB, and Respondents, fully expected that a cross-border solution would be achieved.

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[5] *See Societe Internationale*, 357 U.S. at 211 (stating that foreign non-producing party's good faith and its efforts to comply with the discovery demands "compel the conclusion on this record that petitioner's failure to satisfy fully the requirements of this production order was due to inability fostered neither by its own conduct nor by circumstances within its control. *It is hardly debatable that fear of criminal prosecution constitutes a weighty excuse for nonproduction, and this excuse is not weakened because the laws preventing compliance are those of a foreign sovereign*." (emphasis added)).

The PCAOB-CSRC-MOF MOU is a substantial realization of that expectation, and the production of the Longtop workpapers demonstrates the efficacy of the CSRC's new procedures. Second, Respondents' longstanding transparency regarding the Chinese legal impediments, including in their registration applications filed with the PCAOB nearly a decade ago, is clear evidence of their good faith. The Division has attempted to twist this transparency into evidence of improper conduct, suggesting that Respondents somehow knew all along that an impasse would develop. But Respondents were in the same position as the PCAOB itself, whose leadership has publicly acknowledged that removal of workpapers from China without authorization was illegal, and which stated its own expectation that any impediments would be resolved through regulator-to-regulator cooperation.[6] That persistence has now paid off for the PCAOB, and as a result it has an MOU with China that is working. In any event, Respondents hardly can be faulted for registering with the PCAOB in good faith long before Dodd-Frank and its requirements regarding production of documents to the SEC were even enacted. Again, the PCAOB's own conduct is the best evidence of Respondents' good faith—the PCAOB has never itself acted to de-register Respondents, and to the contrary, has allowed them to remain registered and in good standing even after recent changes in corporate forms.

The evidence presented at the hearing also made clear that principles of international comity dictate that the Section 106 requests are not enforceable because a clear alternative means for obtaining the documents exists and all of the other relevant factors weigh against enforcement as well. As a matter of statutory construction and due process, there can be no finding of a "willful refusal" to produce documents in response to document requests that are

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[6] Respondents Ex. 258, at 7; Respondents Ex. 259, at 11-12. Indeed, as described below, if the Division's theory on PCAOB registration were correct, numerous accounting firms throughout the world, including those discussed below, acted in bad faith by registering with knowledge of legal impediments in their application for PCAOB registration. *See infra* note 39 and accompanying text.

themselves unenforceable. The hearing evidence has also demonstrated that Respondents' legal obligations were uncertain before this case of first impression, and therefore there can be no finding of willfulness under the Supreme Court's decision in *Safeco Insurance Co. of America v. Burr*, 551 U.S. 47 (2007).

Finally, *as to sanctions*, even putting aside that the law and the facts foreclose any finding of liability, any sanction imposed on Respondents would be inappropriate and manifestly contrary to the public interest. It would also constitute arbitrary and capricious agency action because it would be inconsistent with the SEC's current and historical positions. The Division has proposed unprecedented sanctions that would unquestionably result in billions of dollars of losses for U.S. investors and effectively bar Chinese issuers from the U.S. securities markets. Such sanctions cannot be imposed through this disciplinary proceeding.[7]

II. THE DIVISION'S INTERPRETATION OF "WILLFUL REFUSAL" IGNORES THE STATUTORY LANGUAGE, STRUCTURE, AND HISTORY, AS WELL AS THE PRINCIPLE OF PRESCRIPTIVE COMITY

A. Section 106's Willful Refusal Standard Requires Proof of Bad Intent or Bad Faith.

In Dodd-Frank, Congress carefully restricted violations of Section 106 to instances only of "willful refusal" to comply with a request from the SEC or PCAOB. 15 U.S.C. § 7216(e); *see* Josephs Tr. 78:17-80:21 (acknowledging that the Division must prove "not just a refusal," but a "willful refusal"). The term "willful refusal" is unique in the federal securities laws. Section 106's plain language, structure, and history, as well as the principle of prescriptive comity, demonstrate that the "willful refusal" standard cannot be satisfied where, as here, firms

[7] Respondents reserve all rights with respect to whether this action was properly served, as well as whether Section 106 is applicable to work for clients for whom Respondents never prepared, furnished, or issued an audit report. Likewise, Respondents reserve all rights with respect to whether an enforceability ruling by a federal court under Section 106 is a necessary precondition for the institution of this action. Respondents presented these arguments in motions for summary disposition, which this Court denied. But Respondents' maintain their position on these issues.

are prohibited by the law of their home country from producing documents and have consistently acted in good faith. Instead, the standard requires proof of bad intent or bad faith. The Division persists in its position to the contrary, but all of the authority it identified in its pre-hearing brief—or during the course of the hearing—fundamentally supports Respondents' construction of "willful refusal."

1. The Plain Language of Section 106 Requires Proof of Bad Intent or Bad Faith.

As DTTC demonstrated in its pre-hearing brief, the plain language of Section 106(e) makes clear that the Division must prove bad intent or bad faith. There are numerous federal statutes in which the word "willful" is used alone, and there are other statutes in which a "refusal" alone is enough to trigger action. *See, e.g.*, 2 U.S.C. § 192; 15 U.S.C. § 78o(b)(4)(D). But Section 106(e) conjoins these words in its "willful refusal" standard.[8] Thus, in construing Section 106(e), each term must be given meaning, and neither "willful" nor "refusal" can be rendered superfluous. *See Astoria Fed. Savs. & Loan Ass'n v. Solimino*, 501 U.S. 104, 112 (1991); *see also Bailey v. United States*, 516 U.S. 137, 146 (1995) ("We assume that Congress used two terms because it intended each term to have a particular, nonsuperfluous meaning."). Put differently, the combination of these two words cannot be given the same meaning as when each word appears alone. But that is precisely what the Division contends.

As the Division argues, the term "willful" sometimes has been construed to require "merely intent to do the act which constitutes a violation of law," and not "intent to violate the law" or "bad purpose." ENF Pre-Hearing Brief at 30 (quotation marks and citation omitted). In

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[8] As explained in DTTC's pre-hearing brief, the "willful refusal" standard thus resembles the types of "paired modifiers" that Congress typically uses in criminal statutes to address heightened standards to establish culpability. *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 60 (2007); *see also Felton v. United States*, 96 U.S. 699, 702 (1878) (construing standard of "knowingly and willfully" to "impl[y] not only a knowledge of the thing, but a determination with a bad intent to do it or to omit doing it").

the Division's examples, however, the term "willful" modifies terms that do not themselves inherently require knowledge or intentionality (e.g., "violation" or "failure"), and so the term "willful" functions to exclude mistakes and mere inadvertence. *See, e.g.*, *Wonsover v. SEC*, 205 F.3d 408 (D.C. Cir. 2000) ("willfully violated"). Section 106, however, pairs the term "willful" with an act, "refusal," that already requires knowing and intentional conduct. *United States v. Boyle*, 469 U.S. 241, 245 n.3 (1985) (noting that the terms "willful neglect" and "refusal" each "impl[y] *intentional* failure") (emphasis added); *United States v. Seigel*, 168 F.2d 143, 147 (D.C. Cir. 1948) (contrasting a "refusal" with an "inadvertent failure"); *see also* Black's Law Dictionary 1447 (4th ed. 1951) (refusal is defined as "the declination of a request or demand, or the omission to comply with some requirement of law, as the result of a positive intention to disobey").[9] Thus, to avoid rendering either word superfluous, the term "willful refusal" must be construed to set a higher standard than a mere conscious action or the "intent to do the act which constitutes a violation of law."

Indeed, construing "willful refusal" to require merely an "intentional act"—no different from Rule 102(e)(1)(iii)'s "willful violation" standard—would render the *entirety* of Section 106(e) superfluous. After Dodd-Frank, Section 106(b) requires that foreign accounting firms "shall" produce the "audit work papers . . . and all other documents of the firm . . . upon request of the Commission . . . ." 15 U.S.C. § 7216(b)(1)(A). Thus, absent Section 106(e), a mere failure to produce documents would be a violation of the securities laws since it would violate Section 106(b), and a "willful" violation would suffice as a basis for a Rule 102(e)(1)(iii) proceeding. 17 C.F.R. § 201.102(e)(1)(iii). But Section 106(e) provides that only a "*willful*

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[9] In its pre-hearing brief, the Division acknowledges that the term "'refusal' implies the positive denial of an application or command, or at least a mental determination not to comply." ENF Pre-Hearing Brief at 30 (citation omitted).

refusal" will be "deemed a violation." If "willful refusal" means the same thing as the term "willful violation," as the Division contends, it would have been wholly unnecessary for Congress to have added Section 106(e). Basic principles of statutory construction do not permit rendering entire sections of a statute superfluous in this manner. *See Pennsylvania Dep't of Pub. Welfare v. Davenport*, 495 U.S. 552, 562 (1990) (expressing "deep reluctance" to interpret statutory provisions "so as to render superfluous other provisions in the same enactment"). "Willful refusal" therefore must mean something different—and establish a higher standard—than the version of mere "willfulness" advanced by the Division. *See* DTTC's Pre-Hearing Brief at 20-21.

Consistent with this approach, when the Supreme Court confronted a statute in which it found that "willful" modified "refusal," it gave meaning to each word and construed the phrase to require a lack of good faith. *Fed. Power Comm'n v. Metro. Edison Co.*, 304 U.S. 375, 387 (1938) ("The qualification that the refusal must be 'willful' fully protects one whose refusal is made in good faith and upon grounds which entitle him to the judgment of the court before obedience is compelled."); *see also Arthur Andersen LLP v. United States*, 544 U.S. 696, 705 n.9, 707 (2005) (rejecting government's argument that the witness tampering statute, 18 U.S.C. § 1512(b), should be construed the same as the obstruction statute, 18 U.S.C. § 1503, because the former modified the word "corruptly" with "knowingly" and under the government's construction the term "corruptly" would do "no limiting work whatsoever").

2. The Structure and Purpose of Section 106 Support a Construction of "Willful Refusal" that Requires Proof of Bad Intent or Bad Faith.

The structure and legislative intent of Section 106 are also inconsistent with a construction of "willful refusal" that would result in liability for foreign firms to comply with the laws of their home countries. The legislative history is clear that Congress was specifically

advised about foreign legal impediments during its consideration of the Dodd-Frank amendments. Respondents Ex. 426, at 10 (U.S. House Committee on Financial Services, *Testimony Concerning Accounting and Auditing Standards: Pending Proposals and Emerging Issues*, James L. Kroeker, Chief Accountant, SEC (May 21, 2010)). For example, in May 2010, SEC Chief Accountant James L. Kroeker testified before Congress about the challenges to accessing "non-U.S. firms and their audit workpapers, particularly in the European Union, Switzerland, and China." *Id.* Mr. Kroeker testified that accessing such workpapers had been "hindered due to the PCAOB's lack of explicit legal authority to share information with its foreign counterparts and other issues related to the coordination of inspections with local authorities *and the resolution of potential conflicts of law*." *Id.* (emphasis added).

So advised, in 2010 Congress passed a number of amendments to SOX designed to support the SEC's and PCAOB's efforts to foster cooperative arrangements with foreign regulators. Dodd-Frank added subsection (f) of Section 106, which expressly authorizes the SEC and PCAOB to permit foreign accounting firms to meet their production obligations "through alternate means, *such as through foreign counterparts* . . . ." 15 U.S.C. § 7216(f) (emphasis added). Congress also made clear that only a "willful refusal" to comply with document demands would constitute a violation of law. 15 U.S.C. § 7216(e). Dodd-Frank also added 15 U.S.C. § 7215(b)(5)(C) so the PCAOB could share inspection information with foreign regulators. The Senate Report explained that this new provision was included because the PCAOB had reported that efforts to obtain inspection information through cooperative sharing arrangements were "impeded" by the fact that the PCAOB, for its part, did not have authority to share its own inspection information with foreign regulators, and the Senate wanted to support these efforts by the PCAOB. S. Rep. 111-176, at 152-53 (2010).

Thus, the Congressional intent underlying the Dodd-Frank amendments clearly was to support the SEC's and PCAOB's efforts to foster cooperative arrangements with foreign regulators. There is no evidence in the legislative history or structure of Section 106 that Congress intended to disregard the laws of foreign sovereigns, or to require that foreign firms violate foreign law on foreign soil in order to produce documents directly to the SEC, rather than proceeding through customary regulator-to-regulator channels. The term "willful refusal" must be construed consistent with this legislative intent.

3. The Principle of Prescriptive Comity Precludes a Construction of "Willful Refusal" That Makes it Illegal to Comply with Foreign Law.

In any event, Section 106 must be construed in accordance with the principle of prescriptive comity. That principle instructs courts to interpret statutes in a manner that "avoid[s] unreasonable interference with the sovereign authority of other nations." *F. Hoffmann-La Roche Ltd. v. Empagran, S.A.*, 542 U.S. 155, 164 (2004) ("This rule of statutory construction cautions courts to assume that legislators take account of the legitimate sovereign interests of other nations when they write American laws."); *see also, e.g., Hartford Fire Ins. Co. v. California*, 509 U.S. 764, 817 (1993) (Scalia, J., dissenting) (explaining that the principle of "prescriptive comity" is "the respect sovereign nations afford each other by limiting the reach of their laws," which is "exercised by legislatures when they enact laws, and courts assume it has been exercised when they come to interpreting the scope of laws their legislatures have enacted"); *Morrison v. National Australia Bank Ltd.*, 130 S. Ct. 2869, 2885 (2010) (given that "foreign countries regulate their domestic securities exchanges and securities transactions occurring within their territorial jurisdiction" and that "the regulation of other countries often differs from ours as to" *inter alia* "what discovery is available," the "probability of

incompatibility with the applicable laws of other countries is so obvious" that Congress would have specifically addressed the subject if it had intended foreign application of U.S. law).

The principle of prescriptive comity does not permit a construction of "willful refusal" that would make good faith efforts by a foreign accounting firm to comply with the laws of its home country (and thereby avoiding commission of a criminal act there) illegal under U.S. law. *See In re Sealed Case*, 825 F.2d at 498-99. To avoid such "unreasonable interference" with foreign law—as the Supreme Court requires—the term "willful refusal" must be construed to at least require the Division to prove that Respondents were not acting in good faith, and specifically that they were not prohibited from producing the requested documents directly to the Division. Indeed, there is a longstanding line of federal court decisions holding that, primarily due to concerns about international comity, the imposition of severe sanctions on a foreign party that cannot produce documents in U.S. litigation because of foreign legal prohibitions should be limited to instances in which the party did not act in good faith.[10] Here, prescriptive comity similarly requires a construction of "willful refusal" in which the Division must prove that Respondents were not acting in good faith before sanctions can be imposed.

B. The Authority Identified By the Division and During the Course of the Proceeding All Supports Respondents' Construction of Willful Refusal.

The Division proposes a construction of "willful refusal" that requires nothing more than an "'intent to do the act which constitutes a violation of the law.'" ENF Pre-Hearing Brief

[10] *See, e.g., Societe Internationale*, 357 U.S. 197 (sanction of dismissal not appropriate where foreign party had acted in good faith but was unable to comply with document demands); *In re Sealed Case*, 825 F.2d at 498-99 (overturning a contempt order for refusal to produce documents to a grand jury on the grounds that compliance would violate a foreign country's bank secrecy laws, in part because the district court "specifically found that the [subject of the contempt order] had acted in good faith throughout these proceedings"); Restatement (Third) of Foreign Relations Laws of the United States § 442(2)(b) (1987) ("a court *or agency* should not ordinarily impose sanctions of contempt, dismissal or default on a party that has failed to comply with the order for production [due to foreign law prohibitions], except in cases of deliberate concealment or removal of information or of a failure to make a good faith effort....") (emphasis added).

at 30 (citation omitted). As explained above, that contention is itself circular, because the violation of the law at issue is defined as a "willful refusal." In any event, the Division makes no effort whatsoever to address the blatant and impermissible superfluity that results from its proffered construction. To the contrary, it relies exclusively on inapposite authority involving statutes using the word "willful" alone, rather than the "willful refusal" formulation at issue here.[11]

None of the authorities cited by the Division in its pre-hearing brief involves the term "willful refusal." Instead, every single case and provision relied on by the Division construes the term "willful" standing alone. *See Wonsover v. SEC*, 205 F.3d 408 (D.C. Cir. 2000) ("willfully violated"); *In the Matter of Peak Wealth Opportunities, LLC*, Exchange Act Rel. No. 69036, Admin. Proc. 3-14979, 2013 WL 812635 (ALJ Order Mar. 5, 2013) ("willfully violated"); *Arthur Lipper Corp. v. SEC*, 547 F.2d 171 (2d Cir. 1976) ("willfully violated"; "willfully aided and abetted"); *Hughes v. SEC*, 174 F.2d 969 (D.C. Cir. 1949) ("willfully violated"); *Mathis v. SEC*, 671 F.3d 210 (2d Cir. 2012) ("willfully made or caused to be made . . . [a] false or misleading [statement of] material fact, or has omitted . . . any material fact").[12] None of these

[11] Tellingly, the Wells Notice issued by the Division in connection with the DTTC Client A matter misstated the legal standard, and contended that DTTC had "willfully violat[ed] Section 106 ... *by failing to provide* the staff with audit workpapers...." ENF Ex. 147 (emphasis added); Josephs Tr. 78:4-80:21. Nowhere did the Wells Notice reference the applicable "willful refusal" standard. *See* ENF Ex. 147. Indeed, all of the other Wells Notices issued to Respondents in this proceeding also misstated the legal standard. *See* ENF Ex. 140 (Wells Notice to BDO China regarding Client A) ("for failing to produce"); ENF Ex. 141 (Wells Notice to EYHM regarding Client B) ("for failing to produce"); ENF Ex. 142 (Wells Notice to EYHM regarding Client C) ("for failing to produce"); ENF Ex. 143 (Wells Notice to KPMG regarding Clients D, E, and F) ("for failing to produce"); ENF Ex. 144 (Wells Notice to DTTC regarding Client G) ("for failing to produce"); ENF Ex. 145 (Wells Notice to PwC Shanghai regarding Client I) ("for failing to produce"); ENF Ex. 146 (Wells Notice to PwC Shanghai regarding Client H) ("for failing to produce").

[12] *See also Tager v. SEC*, 344 F.2d 5 (2d Cir. 1965) ("willfully violated"); *In re Dominick & Dominick, Inc.*, 50 S.E.C. 71, 1991 WL 294209 (May 29, 1991) ("willfully violated"; "willfully aided and abetted"); *In the Matter of Amaroq Asset Mgmt., LLC*, Initial Decision Rel. No. 351, 93 SEC Docket 2231, 2008 WL 2744866 (July 14, 2008) ("willfully violated"; "willfully aided and abetted"); *Vineland*

cases or provisions addresses the "willful refusal" standard—or even any comparable standard—and therefore does not answer the fundamental question in this proceeding.[13]

For example, the Division cites *Peak Wealth Opportunities LLC* for the proposition that willfulness requires only an "intent to do the act which constitutes a violation of the law." ENF Pre-Hearing Brief at 30, 34. That case involved consideration of the term "willful"—standing alone—under Rule 102(e)(1)(iii) and corresponding provisions of the Advisers Act; it did not consider the term "willful refusal." 2013 WL 812635, at *5-8. But the question here is not simply what "willful" means under Rule 102(e)(1)(iii). There is no underlying violation of the federal securities laws ("willful" or otherwise) unless Section 106's "willful refusal" standard

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Fireworks Co., Inc. v. Bureau of Alcohol, Tobacco, Firearms & Explosives, 544 F.3d 509, 517 (3d Cir. 2008) ("willfully violated"); *Harrington v. United States*, 504 F.2d 1306 (1st Cir. 1974) ("willfully fails"); 15 U.S.C. 78o(b)(4)(A) ("willfully made or caused to be made"); 15 U.S.C. 78u-2 ("willfully violated"; "willfully aided, abetted, counseled, commanded, induced, or procured such a violation"; "willfully made or caused to be made"); 15 U.S.C. 78o(b)(4)(D) ("willfully violated"); 15 U.S.C. 78o(b)(4)(E) ("willfully aided, abetted, counseled, commanded, induced, or procured the violation"); 15 U.S.C. 78o(b)(6)(B) ("willfully to become, or to be, associated with a broker or dealer in contravention of such order").

[13] The Division has similarly made no attempt to address the way in which Section 106 stands in sharp contrast to other provisions of the Securities Act, the Exchange Act, and even SOX itself. As explained in DTTC's pre-hearing brief, Section 22(b) of the Securities Act and Section 21(c) of the Exchange Act permit the SEC to seek judicial enforcement of a subpoena "[i]n case of contumacy by, or *refusal* to obey a subpoena," and even if such a court order is violated, that is not deemed a violation of the federal securities laws. *See* 15 U.S.C. § 78u(c) (emphasis added); 15 U.S.C. § 77v(b). Similarly, with respect to provisions governing document demands to brokers and dealers, Exchange Act Rule 17a-4(j) requires brokers and dealers to "furnish promptly" copies of their records upon request by the Commission. 17 C.F.R. § 240.17a-4(j). It does not provide that only a "willful refusal" is a violation of the Exchange Act. *See In re Dominick & Dominick, Inc.*, 50 S.E.C. 71, 1991 WL 294209 (May 29, 1991) (a broker's failure to furnish promptly records on the grounds that it was prohibited by Swiss law constituted violation of Rule 17a-4(j), and therefore justified sanction under 15 U.S.C. § 78o(b)(4)(D), which covers *both* "willful violations" of, and the inability to comply with securities laws). And the provision that precedes Section 106 in SOX (*i.e.*, Section 105) permits sanctions against a registered accounting firm that merely "refuses" to cooperate with a PCAOB investigation. 15 U.S.C. § 7215(b)(3). Unlike these provisions, Congress included in Section 106 the requirement that only an accounting firm's "*willful refusal*" to produce documents violates the federal securities laws. This legislative choice must be given proper effect.

has been satisfied.[14] Thus, applying the analysis in *Peak Wealth Opportunities LLC* does not answer the fundamental question in this proceeding.

Similarly, none of the authority referenced during the course of the hearing offers any support to the Division's interpretation of "willful refusal." Instead, it all demonstrates the need to construe "willful refusal" as requiring proof of lack of good faith or conscious wrongdoing.

First, during the hearing, the Court raised the decision in *In the Matter of the Application of R.E. Bassie & Co. and R. Everett Bassie, C.P.A.*, Exchange Act Rel. No. 3354, 2012 WL 90269 (Jan. 10, 2012). *See* Tr. 1229:21-1231:14. In that matter, the Commission sustained sanctions imposed on a public accounting firm for its "refusal" to cooperate with a Board investigation under Section 105(b)(3) of SOX. 2012 WL 90269, at *1; *see* 15 U.S.C. 7215(b)(3) (authorizing the Board to sanction a firm if it "*refuses* to testify, produce documents, or otherwise cooperate with the Board in connection with an investigation") (emphasis added). The decision thus underscores the Congressional choice to establish mere "refusal" as the standard in Section 105 while using the "willful refusal" standard in Section 106 when addressing foreign accounting firms specifically—a difference that must be given effect as a matter of statutory construction. *Cf. Potter v. United States*, 155 U.S. 438, 446 (1894) (word "willful" used to describe certain offenses but not others in same statute "cannot be regarded as mere surplusage; it means something").

Factually, moreover, the *Bassie* matter provides no meaningful guidance for the instant proceeding. The main question was whether a "refusal" need be express or whether it can

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14 By contrast, in *Peak Wealth Opportunities LLC*, the underlying securities laws simply required Peak Wealth to "furnish" certain information to a fund director, 15 U.S.C. § 80a-15(c), "make and keep [certain] records," 15 U.S.C. § 80b-4(a) and 17 C.F.R. § 275.204-1(a)(1), and "amend [a] Form ADV" under certain circumstances, 17 C.F.R. § 275.204-1(a)(1). Such provisions are very different from the "willful refusal" standard at issue here. They do not themselves include the word "willful," and plainly could be violated without knowledge or by mere inadvertence.

be implied from conduct that demonstrates a conscious choice not to cooperate. *See* 2012 WL 90269, at *7. There was no issue of foreign legal impediments in that case; rather, the Board and Commission expressly found the "absence of any mitigating circumstances" to inform their conclusion as to liability. *Id.* at *12. Further, the respondents in *Bassie* had engaged in a "protracted campaign of stalling and delay" and ultimately "laps[ed] into total noncommunication" with the PCAOB. *Id.* Nothing resembling those facts is present here.

In discussing the *Bassie* decision, the Court noted that the PCAOB has implemented rules that permit the initiation of non-cooperation proceedings where a firm or individual "may have *failed* to comply with an accounting board demand"—rules that do not use the term "refuse," as set forth in Section 105. PCAOB Rule 5110 (emphasis added); *see* PCAOB Rule 5300(b) (authorizing sanctions were firm "has *failed* to comply with an accounting board demand") (emphasis added); *see also* Tr. 1230:6-21. That issue, however, was not squarely addressed in *Bassie* because both the PCAOB and the Commission concluded that respondents had, in fact, "refused" to cooperate. *See, e.g.*, 2012 WL 90269, at *12 (holding that respondents had "refused" to cooperate and that their conduct constituted "intentional or knowing conduct"). The Board held (and the Commission agreed) that a "refusal need not be express" because otherwise a firm or associated person could avoid sanctions "merely by refraining from expressly articulating a refusal to cooperate." *Id.* at *6. Ultimately, whether an agency rule can properly modify a legal standard that has been set by Congress raises complicated issues, but they need not be addressed in this proceeding. The Commission has engaged in no similar rulemaking with respect to Section 106, and so the "willful refusal" standard unquestionably governs here.

Second, during the hearing, this Court also noted the Second Circuit's recent decision in *SEC v. Razmilovic*. --- F.3d ---, 2013 WL 3779339 (2d Cir. July 22, 2013); *see* Tr. 1902:3-

1903:2. That case involved Federal Rule of Civil Procedure 37(b)(2)(A), which authorizes a court to sanction a party that simply "*fails* to obey an order to provide or permit discovery" (emphasis added). Such sanctions may include a "default judgment" if the "fail[ure] to obey" was "willful." *Razmilovic*, 2013 WL 3779339, at *7. Thus, *Razmilovic* is yet another case that considers mere "willful failure," and not the more exacting "willful refusal" standard.[15] The *Razmilovic* case is further inapposite because it did not involve any foreign legal impediments to complying with U.S. discovery orders. Indeed, the defendant there admittedly was free under foreign law to appear in the U.S. for the required deposition, but did not do so because he was abroad and "considered a fugitive by the United Sates Department of Justice." *Id.* at *2. The defendant himself agreed in the district court that his conduct warranted a Rule 37 sanction and, on appeal, he did "not even attempt to argue that the court's finding of willfulness was erroneous." *Id.* at *4, *9. Again, such facts and circumstances are far removed from those here.

Third, during its cross-examination of Mr. Atkins, the Division referenced the Commission's decision in *In the Matter of the Application of Dagong Global Credit Rating Co.*, Exchange Act Rel. No. 62968, 2010 WL 3696139 (Sept. 22, 2010). *See* Atkins Tr. 2676:8-2679:3. That decision powerfully underscores the heightened standard that the Division must, but cannot, meet here. That matter involved the Commission's denial of the application of a Chinese credit rating agency ("Dagong") that sought registration as a Nationally Recognized Statistical Rating Organization ("NRSRO"). The Commission is required to deny such an

[15] At one point, the decision explains that the lower court "found that Razmilovic's refusal to appear was 'willful and intentional.'" *Razmilovic*, 2013 WL 3779339, at *3; *see also* Tr. 1902:21-23 ("the judge found that he willfully refused to show up at his deposition and found him in default"). But that statement is simply an informal description of the defendant's conduct and not a precise statement of the legal holding, which was that the defendant's "*fail[ure]*" under Federal Rule of Civil Procedure 37 was "willful." *SEC v. Symbol Technologies*, No. CV-04-2276, 2010 WL 744359, at *3 (E.D.N.Y. Feb. 25, 2010).

application if it finds that an applicant, if registered, "would be subject to suspension or revocation." 15 U.S.C. 78o-7(a)(2)(C)(ii)(II). An NRSRO is subject to suspension or revocation if it has committed an act prohibited by, among other things, 15 U.S.C. § 78o(b)(4)(D). *See* 15 U.S.C. §78o-7(d)(1)(A). And under 15 U.S.C. § 78o(b)(4)(D), an NRSRO is subject to sanction if it "*willfully violated* any provision of the Securities Act of 1933 . . . [or] the rules or regulations under [that statute] . . . ***or*** is *unable to comply* with any such provision." (emphasis added).

These provisions thus explicitly distinguish "willfully violated" from "unable to comply," and the Commission denied Dagong's application solely on the ground that Chinese law may render Dagong "*unable to comply*" with document production and inspection obligations. 2010 WL 3696139, at *1, *6; *see also* Atkins Tr. 2676:19-24 ("[A]re you aware that the reason the Commission rejected the application was because the Commission *could not conclude that Dagong could comply* with the requisite recordkeeping, production and examination requirements of the U.S. securities laws?") (emphasis added). Tellingly, the Commission did not reject Dagong's application on the basis that Dagong's adherence to Chinese law would constitute a "willful violation" of the federal securities laws. The Commission's decision thus tacitly acknowledges that compliance with foreign legal obligations may not even be a "willful violation"—much less satisfy the even more demanding standard of "willful refusal."

Ultimately, the Division simply ignores the plain language of Section 106, pretends that the applicable standard is mere "willfulness," and urges the Court to commit the same error. There can be no doubt, however, that the standard is more exacting under Section 106(e), and requires proof of bad intent or bad faith.

C. Even Mere Willfulness Is Not Satisfied By the Good Faith Inability to Comply Due to Foreign Legal Impediments.

Even if the Division were correct (which it is not) that the term "willful refusal" simply requires "intent to do the act which constitutes a violation of law"—and therefore merely means the same thing "willfulness" has sometimes been construed to mean—it nonetheless would not be satisfied where a foreign firm acts in good faith but is unable to comply due to foreign legal impediments.

A long line of authorities, including a decision by the U.S. Supreme Court, have made clear that a foreign party's inability to comply with document demands without violating foreign law is distinct from—and does not constitute—the type of mere "willfulness" the Division references. *Societe Internationale*, 357 U.S. at 212 ("Rule 37 should not be construed to authorize dismissal . . . when it has been established that failure to comply has been due to *inability*, and *not to willfulness*, bad faith, or any fault of petitioner." (emphasis added)); *In re Westinghouse Elec. Corp. Uranium Contracts Litig.*, 563 F.2d 992, 996-97 (10th Cir. 1977) (necessary to consider whether failure to comply with discovery was due to inability, and not to willfulness, bad faith or any fault of the non-producing party); *Shcherbakovskiy v. Da Capo Al Fine, Ltd.*, 490 F.3d 130, 139 (2d Cir. 2007) ("the inquiry into *Russian law* ... will inform a finding as to appellant's *willfulness*, or lack thereof, in *refusing* to produce the documents") (emphasis added). Indeed, this line of authority has considered the type of sanctions for noncompliance with discovery orders that require proof of willfulness, such as contempt or default judgment. And they have held that a foreign party's good faith inability to comply without violating foreign law does not constitute willfulness and therefore cannot support such sanctions. The same is true here: if Section 106(e) is construed as the Division proposes, that standard is not met on this record.

Such an approach is also consistent with the longstanding principle that for a party to act "willfully," it must act "without justifiable excuse." Black's Law Dictionary 1434 (5th ed. 1979); *see also Bryan v. United States*, 524 U.S. 184, 192 n.12 (1998) ("willful" means, among other things, "without justifiable excuse" (quotation and citation omitted)). And there can be no doubt that a foreign party's good faith inability to produce documents without violating the law of its home country is a "justifiable excuse" that precludes a finding of willfulness.

The Division has not provided (and cannot provide) any rebuttal to this point, and its own focus on Chinese law and good faith effectively concedes this point. Thus, even under its own proffered standard, the Division cannot prevail here.

III. THE DIVISION HAS FAILED TO DEMONSTRATE THAT RESPONDENTS "WILLFULLY REFUSED" TO PRODUCE DOCUMENTS

The Division has not carried its burden of proving that Respondents "willfully refused" to produce audit workpapers and other documents to the SEC. Indeed, the hearing evidence decisively undermined the key factual assertions the Division made in its pre-hearing brief regarding its purported proof of Respondents' "willful refusal": (1) the evidence established that Respondents are, in fact, prohibited by Chinese law and the explicit instructions of their Chinese regulators from producing any of the requested documents directly to the SEC; (2) Respondents are not responsible for the legal impediments they currently face, and have made substantial efforts to facilitate a production of the requested documents; and (3) Respondents' registration with the PCAOB—and their continuing audit work pursuant to that registration—cannot possibly serve as evidence of a lack of good faith.[16] Ultimately, the evidence is indisputable that Respondents have nothing to hide and would produce the audit workpapers

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[16] While arguing at some points that the issue of good faith was not relevant in its pre-hearing brief, the Division committed that it would prove at the hearing that Respondents acted in bad faith. ENF Pre-Hearing Brief at 50-52 ("Assuming, *arguendo*, the Division has the burden of proof on the issue, the result is no different: Respondents have not acted in good faith.").

directly to the SEC if permitted by Chinese law. *See, e.g.*, Leung Tr. 1407:9-22; *see also* Chiu Tr. 1789:4-1790:9 (clarifying that the CSRC's instructions for production of workpapers in 2013 precluded the firms from deleting materials reflecting any possible deficiencies in their audit work).

A. Respondents Are Prohibited by Chinese Law and Express Instructions From Producing the Requested Documents Directly to the SEC.

The Division's pre-hearing brief repeatedly contended that the evidence did not—and would not—show "that an actual conflict of law exists." *See, e.g.*, ENF Pre-Hearing Brief at 4. The hearing record—including the testimony of the Division's own Chinese law expert—conclusively disproves that assertion. Indeed, as demonstrated in DTTC's pre-hearing brief, the SEC's and PCAOB's leadership has acknowledged the legal impediments to the production of audit workpapers located in China. For example, in a 2012 speech, PCAOB Board Member Lewis Ferguson explained unambiguously that "[u]nder Chinese law, it is illegal to remove audit work papers from China." Respondents Ex. 258, at 7. Similarly, former SEC Chairman Schapiro explained to Congress in 2011 that China views the SEC's efforts to obtain "direct access to witnesses and information" as "a possible violation of sovereignty and/or national interest." Respondents Ex. 241, at 6-7 (Letter from SEC Chairman M. Schapiro to Chairman P. McHenry (House Subcommittee on TARP, Financial Services, and Bailouts of Public and Private Programs – Committee on Oversight and Government Reform) (Apr. 27, 2011)). The Division itself has previously taken the same position in the *Longtop* matter.[17]

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[17] *See* SEC's Reply Memorandum in Support of Its Application for Order Requiring Compliance with Subpoena at 3 (D.D.C. Dec. 3, 2012) (stating that the SEC "does not contend—particularly in light of statements by the CSRC since the filing of this action—that DTTC bears no risk in complying with the Subpoena"); *see also id.* at 12 ("[T]he SEC does not contend that DTTC bears no risk in complying with the Subpoena. . . ."); *id.* at 16 n.8 ("[W]e do not dispute that some sanctions could be imposed upon DTTC . . . .").

Ultimately, the evidence is clear that a series of binding oral and written directives from the Chinese regulators and Chinese law prohibits Respondents from directly producing the documents to the SEC, and that they would face severe consequences for disobeying these laws.

1. The CSRC and MOF's Oral Directives

a. The Evidence Conclusively Establishes That Respondents Received Oral Directives From the CSRC and MOF.

During the hearing, witness after witness testified that the CSRC and MOF clearly instructed Respondents that they were prohibited from producing the requested documents directly to the SEC and that any productions to a foreign regulator must go through the CSRC. The Division produced no evidence to the contrary, and merely argues that this Court should disregard such witness testimony about these oral instructions as a "very slender evidentiary reed. . . ." ENF Pre-Hearing Brief at 4. But the combined force of this testimony is overwhelming and establishes beyond any doubt that these oral instructions were given, that they carry the force of law, and that Respondents genuinely believed they had no choice but to follow them.

In March 2011, the Division issued a Section 106 request to DTTC concerning DTTC Client A. In accordance with Chinese law and as any reasonable Chinese firm would do, DTTC contacted the CSRC about the request. Feinerman Tr. 2515:7-19; Tang Tr. 2411:8-2416:22; Feinerman Expert Report ¶ 44; Feinerman Rebuttal Report ¶ 4; Tang Expert Report ¶ 4; Tang Rebuttal Report ¶¶ 3, 4, 24, 46, 47; George Tr. 1601:16-1602:11. The CSRC provided its unequivocal response in April 2011. Specifically, the CSRC stated that "audit working papers will not be produced by DTTC directly to the SEC. [The CSRC] indicated that the appropriate channel for the production of [DTTC] Client A working papers would be through the CSRC

themselves." George Tr. 1602:12-18; Respondents Ex. 97, at 2 (Letter from prior DTTC counsel to SEC (Apr. 29, 2011)).

Shortly thereafter, in May 2011, the Division made a voluntary request for Dahua's workpapers related to its Client A. Dahua contacted the MOF for guidance, and the director of the MOF "replied that according to Chinese laws, Dahua is not allowed to provide work papers to SEC directly [sic]." Ji Tr. 2062:21-2064:8. Similarly, in July 2011, representatives from EYHM met with the CSRC and MOF in relation to a voluntary request it had received from the Division regarding Client B. Leung Tr. 1411:12-22. Mr. Leung testified that at the meeting with the CSRC, he was told that "accounting firms are not allowed to provide working paper[s] directly to foreign regulators." Leung Tr. 1414:8-12. Later that day, Mr. Leung met with the MOF and was instructed "that accounting firms are not allowed to provide working papers to foreign regulators and foreign regulators requiring working paper[s] should contact PRC regulators to work out some arrangements." Leung Tr. 1416:21-1418:9.

On October 10, 2011, all five Respondents (along with another China-based firm) were summoned on very short notice to a meeting with representatives of the CSRC and the MOF. *See, e.g.*, Leung Tr. 1427:1:5; Ji Tr. 2064:9-19. As the witnesses who personally participated in that meeting testified, the CSRC and MOF representatives unequivocally stated that, under Chinese law, the firms were not permitted to produce audit workpapers and other documentation directly to foreign regulators (including the SEC) without the consent of the CSRC and MOF. Chao Tr. 1292:3-10, 1294:20-1295:3; Yan Tr. 1915:8-1916:20; Ji Tr. 2064:9-2065:12; *see also* Yan Tr. 1920:6-11. The regulators made clear this was a "sovereign issue" and any such productions must be made through the CSRC. Chao Tr. 1294:3-1296:3. The meeting was indisputably significant: a joint meeting held by the CSRC and MOF was

unprecedented, the request to attend was "urgent," the officials were "very concerned" about the growing number of requests from U.S. regulators, and they made clear that the consequences for ignoring their directives would be "very serious." Chao Tr. 1292:3-1295:3.

Even after these unambiguous and powerful instructions were given, Respondents continued their dialogue with the CSRC and MOF in order to update the regulators on developments in the U.S. and to pursue ways to facilitate production of the requested documents. However, the Chinese regulators' position regarding a direct production by Respondents did not change.

- On October 17, 2011, Raymond Chao, Alfred Lum, and Debra Wong from PwC Shanghai attended a meeting with the CSRC regarding Client I. Chao Tr. 1297:19-1298:23; Wong, D. Tr. 1862:23-1863:3. Again, they were told that PwC Shanghai was not to produce documents directly to a foreign regulator, and it had "done the right thing in terms of working through [the CSRC]." Chao Tr. 1299:1-11; Wong, D. Tr. 1862:23-1863:3.
- In early December 2011, the CSRC told EYHM during a meeting that it was "not allowed to provide working papers to foreign regulators and that [it] doesn't matter whether those working paper [sic] are disallowed by PRC law or not." Leung Tr. 1449:1-1450:12.
- After receiving the Section 106 requests in February 2012, EYHM, KPMG Huazhen, PwC Shanghai, and DTTC met with the CSRC and MOF and were given the same instructions: PRC firms are not allowed to provide working papers directly to the SEC. Leung Tr. 1459:3-1463:19; Wong, D. Tr. 1873:5-1876:19; Yan Tr. 1921:15-24.

- After receiving a formal request for workpapers from the SEC in February 2012, Dahua contacted the CSRC which again instructed that Dahua could not produce workpapers and related documents directly to overseas agencies. Ji Tr. 2089:15-2090:8.
- In May 2012, after receiving Wells notices regarding Clients A and C respectively, Dahua and EYHM each contacted the CSRC and MOF again, and received the same message that had been conveyed in earlier meetings. Leung Tr. 1467:8-1468:13; Ji Tr. 2090:16-2092:17. During a meeting with Chinese regulators, EYHM was told not to directly produce documents to the SEC. Leung Tr. 1467:8-1468:13. In separate oral communications, the CSRC explicitly said that Dahua could not produce the documents. Ji Tr. 2090:16-2092:17.
- In December 2012, after the OIP was issued in this proceeding, Respondents organized and attended yet another meeting with the CSRC and MOF. But they were again told that they could not produce documents directly to a foreign regulator. Leung Tr. 1469:4-1470:20; Wong, D. Tr. 1876:20-1878:2; Yan Tr. 1922:4-1923:7; Ji Tr. 2095:13-2096:14.
- In June 2013, after the PCAOB successfully negotiated an MOU with the CSRC and MOF, most of the Respondents attended a meeting with the CSRC and MOF. At the meeting, Respondents expressed that they were "ready and willing" to produce workpapers, but were advised to follow required protocols and that the firms "cannot act unilaterally." Yan Tr. 1923:8-1924:21.

This compelling, consistent and undisputed witness testimony regarding the oral instructions is directly corroborated by contemporaneous writings to both the SEC and CSRC itself. For example, shortly after DTTC received instructions from the CSRC in April 2011, it memorialized those instructions in a letter that DTTC's then-counsel sent to the SEC on April

29, 2011. Respondents Ex. 97, at 2. The letter stated that "[o]n April 19, 2011, Li Hai Jun, an officer in the Accounting Department of the CSRC's Beijing office, advised [DTTC] that the CSRC would address any future production of documents to the SEC, that a direct production by [DTTC] to the SEC is not permitted, and that the CSRC could not provide a written confirmation of its position." Respondents Ex. 97, at 2. Similarly, letters from PwC Shanghai's counsel and DTTC's counsel to the SEC on November 2, 2011 and November 10, 2011, respectively, confirm that the CSRC told Respondents at the October 10 meeting that they could not unilaterally produce documents. Respondents Ex. 396, at SEC_H0-11604_Wells_0000448 ("The officials made clear that the audit firms must not [provide workpapers directly to any foreign regulator] and that the only appropriate way under Chinese law to respond to a request of a foreign regulator for such workpapers and related materials was to refer the request to the CSRC and for the foreign regulator to work directly with the CSRC."); Respondents Ex. 130, at DTTC-LT-0000185 ("The CSRC and MOF also directed that any requests by the SEC or PCAOB to DTTC must be made through the regulatory authorities of China, and not directly through DTTC.").

Respondents also wrote contemporaneous letters to the CSRC itself in which they memorialized the oral instructions they had received. On August 10, 2011, DTTC sent a letter to Li Hai Jun of the CSRC (*i.e.*, the same individual referenced in DTTC's April 29, 2011 letter, *see* Respondents Ex. 97, at 2) stating that: "[i]n March 2011, SEC staffers asked DTTC to produce the documents directly to the United States; *DTTC sought guidance from the CSRC, and the CSRC told DTTC that this firm could not do so*. DTTC has complied with and will continue to abide by the CSRC's direction." Respondents Ex. 116A (emphasis added). Similarly, on October 17, 2011, PwC Shanghai wrote a letter to the CSRC stating that it understood the

instructions from the CSRC at the October 10, 2011 meeting to mean that "without your prior consent, we are not allowed to provide any such audit work papers or relevant audit information to foreign regulators." Respondents Ex. 393A, at 1-2. In February 2012, KPMG Huazhen also wrote a letter to the CSRC that expressed its understanding based on all of the meetings it had attended with the CSRC: "Any provision of our audit work papers and other documents to PCAOB without the appropriate permissions of the relevant PRC authorities, including the [CSRC], will result in legal liabilities for us and our employees." Respondents Ex. 551A, at 1.[18] And in March 2012, PwC Shanghai again wrote to the CSRC upon receiving the Section 106 notice related to Client H and indicated that "[b]ased on the previous communications with the CSRC, we understand that we are not permitted to produce the relevant documents as requested by the two Section 106 Notices, direct [*sic*] to the SEC." Respondents Ex. 409A.

It is simply impossible to conclude that Respondents sent multiple letters to their regulator in China—the CSRC—specifically describing oral instructions that the CSRC had never, in fact, given. These contemporaneous written documents—paired with the witness testimony—absolutely confirm the CSRC's and MOF's clear oral instructions to Respondents.

b. These Oral Directives Are Binding and Carry the Force of Law

The record also established that the type of less formal or unwritten guidance repeatedly provided to Respondents by the CSRC—known as "neibu"—is binding in China and carries the force of law. Professors Tang and Feinerman unequivocally explained the mandatory and binding nature of such directives, and the peril that Respondents would face for violating them. Tang Tr. 2412:8-2413:5 (oral directives from the CSRC "have a legal binding effect");

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[18] To similar effect, on behalf of EYHM, Mr. Leung wrote six such letters to the CSRC (Respondents Exs. 18A, 22A, 25A, 26A, 30A, and 33A) and two to the MOF (Respondents Exs. 19A and 32A) responding to the regulators' instructions, and repeatedly seeking ways to comply with the requests of the Division, including by producing the documents to the CSRC.

Feinerman Tr. 2518:3-2519:9 ("I believe that those oral instructions [given to Respondents], along with the written guidance and the statutory and regulatory provisions I have mentioned before, clearly have a binding force of law."). Indeed, oral directives—often confidential—"remain one of the most common forms of binding regulatory guidance in China." Feinerman Rebuttal Report ¶ 4; Feinerman Tr. 2518:23-2519:9; *see also* Feinerman Expert Report ¶ 37 ("The vast majority of administrative guidance provided by Chinese regulators to regulated entities is still largely unwritten or 'internal' (in Chinese '*neibu*')."). Not only are they binding in their own right, such directives are also critical to properly interpreting Chinese statutory law. Feinerman Rebuttal Report ¶¶ 29, 31.

Remarkably, the Division's own expert—Professor Clarke—provides no opinion whatsoever on these oral directives.[19] To be sure, Professor Clarke's own report seems to concede that such directives have the force of law. Clarke Expert Report ¶ 17 n. 28 (acknowledging that oral directions can be categorized as "'law'"). And, in any event, his past writings unequivocally acknowledge the importance of such oral guidance. Clarke Tr. 2397:14-20 (acknowledging that "assertions about the functioning of the Chinese legal system can never stop simply with observations about what the formal law says"); Feinerman Tr. 2557:22-2558:6. With this critical issue left unaddressed, Professor Clarke's opinion on Chinese law effectively amounts to no opinion at all.

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[19] Clarke Tr. 2357:11-14 (agreeing that his opinion is limited to written materials only); *id.* at 2360:8-12 (agreeing that his opinion "does not address the impact, if any, of any oral instructions"); *id.* at 2365:20-25 (agreeing that he is "not offering an opinion on the significance of any oral directives"); Clarke Expert Report ¶ 43 ("In particular, Respondents highlight meetings in October 2011 in which they state that they received directions not to produce documents directly to the SEC. *I do not address these contentions in this Report*, except to note that the referenced letters do not contain any such explicit direction.") (emphasis added); Clarke Expert Report ¶ 55 ("Putting aside other oral instructions from the CSRC (*assertions about which, as noted above, I do not express an opinion in this Report....*") (emphasis added); Feinerman Tr. 2556:7-9 (in which Mr. Mendel asked "[a]nd isn't it true, sir, that Professor Clarke was addressing written Chinese law and not all Chinese directives issued orally?").

The oral instructions are therefore alone sufficient to answer the question whether Respondents are prohibited from producing documents directly to the CSRC. The record leaves no option but to conclude that the oral instructions were given, and that Respondents could not, and cannot, disobey them without violating Chinese law.

c. Contrary to the Division's Assertions, the Evidence Proving the Oral Directives Is Not Hearsay and Is Highly Credible

In the face of overwhelming, uncontroverted evidence that Respondents received binding oral directives from the CSRC, the Division's only counter has been to suggest that Respondents' proof is limited to "hearsay by biased witnesses." ENF Pre-Hearing Brief at 49. That position is wrong for multiple reasons.

First, as the Court noted during the final pre-hearing conference and during the hearing itself, hearsay evidence is admissible in SEC administrative proceedings. *See In re Alacan*, Exchange Act Rel. No. 49970, 2004 WL 1496843, at *6 (July 6, 2004) ("As we repeatedly have held, hearsay evidence is admissible in our administrative proceedings and, in an appropriate case, may even form the sole basis for findings of fact." (internal quotation marks omitted)). In any event, Respondents' witness testimony about the oral directives *is not hearsay* as a matter of law because it is not being offered to prove the truth of the matter asserted. *See* Fed. R. Evid. 801(c). Instead, testimony concerning the oral directives was offered by Respondents to demonstrate that such directives were heard or received by Respondents, and evidenced their state of mind at the time, both of which are permissible, non-hearsay purposes. *See, e.g., United States v. Baird*, 29 F.3d 647, 653 (D.C. Cir. 1994) (finding that an out-of-court instruction about a legal obligation should have been admitted to show lack of scienter).[20] Thus,

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[20] Further, oral instructions provided by Chinese regulators would not be inadmissible hearsay under the federal rules because they constitute "verbal acts" having independent evidentiary significance.

even if the Federal Rules of Evidence were applicable (and they are not), the testimony would not constitute hearsay.

Second, the record has also decisively undercut the Division's contention that this testimony has "low 'probative value and reliability.'" *See* ENF Pre-Hearing Brief at 49. As discussed above, witness testimony concerning the oral instructions was clear, consistent, and compelling. And it was supported and corroborated by contemporaneous writings—including numerous letters to the CSRC itself. The Division can no longer credibly challenge the veracity of Respondents' claim that the Chinese regulators gave explicit instructions that prohibited Respondents from producing documents.[21]

2. Chinese Written Laws and Directives

In addition, the evidence makes clear that there is *no dispute* among the expert witnesses that formal written Chinese laws and directives prohibit Respondents from producing any of the requested documents directly to the SEC without the approval of the Chinese authorities. *See* Clarke Tr. 2390:15-2391:15 ("Q: So we can agree that approval is generally required by some Chinese regulatory authority before [workpapers] can be transferred abroad? A: Yes . . . ."). The Division's Chinese law expert witness has mustered only the quibble that

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See Fed. R. Evid. 801(c) advisory committee's note (explaining that the definition of hearsay does not include a "statement [that] itself affects the legal rights of [a party]"); Charles A. Wright et al., 30B Federal Practice & Procedure: Evidence § 7005 n.2 (2d ed. 2006) (noting that "[c]ommands, instructions and directives are often verbal acts having independent legal significance" and thus are not hearsay) (internal quotation marks omitted).

[21] Likewise, any suggestion by the Division that CSRC officials should have testified is divorced from reality. ENF Pre-Hearing Brief at 4 ("Respondents will not provide any testimony from the CSRC."). Given the weight of evidence offered at the hearing, and the fact that the Division offered no contrary evidence, no testimony was needed from CSRC officials on this point. In any event, requiring CSRC officials to be subject to SEC examination runs afoul of even the most basic respect for China's sovereignty, and the Division can point to no authority, and we know of none, that confers upon Respondents the ability to call, let alone compel, those regulators to attend a trial in the United States. The Division's attempt to punish Respondents for failure to do the impossible in another circumstance is telling.

although written law requires that Respondents obtain approval from the State Archives Administration ("SAA") and State Secrets Bureau ("SSB") before producing workpapers to foreign regulators, he does not believe it explicitly requires approval from the *CSRC* in particular. *Id.* at 2391:7-2392:3. This sort of nitpicking as to how Respondents should have approached the Chinese government is plainly insufficient to demonstrate Respondents' bad faith. And in any event, the Division and Professor Clarke are wrong about the law.

A number of provisions of formal Chinese law clearly establish the CSRC as the Chinese regulator responsible for managing foreign regulators' attempts to obtain documents from China-based firms, and that the CSRC—and not Respondents—is responsible for coordinating with other relevant authorities (such as the SSB and SAA) as necessary. *See, e.g.*, Tang Expert Report ¶ 33; Tang Rebuttal Report ¶¶ 22-24, 31; Feinerman Rebuttal Report ¶¶ 4, 15, 19-26.

- First, under Article 179 of the Law of the People's Republic of China on Securities ("Securities Law"), the CSRC has the authority to "establish a co-operative mechanism of supervision and regulation in collaboration with foreign securities regulators..." Tang Expert Report ¶ 33. Article 3.12 of the Provisions on Function Allocation, Internal Department Arrangement and Personnel Make-up of the China Securities Regulatory Commission makes clear that the CSRC is the only government authority to which the State Council has granted this authority. Tang Expert Report ¶ 33.
- Second, Regulation 29 reiterates and emphasizes this authority in the specific context of cross-border securities regulation matters that involve "confidentiality and archives administration." Tang Expert Report, Ex. 2, Item 15; Tang Rebuttal Report ¶ 23.

Article 7 of Regulation 29, which applies to on-site and off-site inspections alike—and which Professor Clarke does not mention in his expert report—provides that "[t]he relevant in-charge authorities such as *the China Securities Regulatory Commission*, the State Secrecy Bureau and the State Archives Administration *shall establish a coordination mechanism* to regulate and inspect, *within their respective scopes of authority and in accordance with the law*, matters arising from the course of any overseas issuance and listing of the securities of an overseas listed company which involve the protection of secrets and archive administration." (emphasis added). Tang Expert Report, Ex. 2, Item 15, ¶ 7. Tang Rebuttal Report ¶¶ 20-24.

- Third, the first paragraph of Article 8, Regulation 29, which Professor Clarke likewise ignores, provides that the "CSRC shall be responsible for carrying out exchanges and co-operation with overseas securities regulatory authorities and other relevant bodies with regard to cross-border securities regulator matters involved in the confidentiality and archives administration during the process of overseas issuance and listing of securities." Tang Expert Report, Ex. 2, Item 15, ¶ 8. Tang Rebuttal Report ¶¶ 25-34.

Professor Clarke contends that, at least to him, the meaning of these provisions is "far from obvious" and "not crystal-clear," but he insists that they do not necessarily require CSRC approval (as opposed to SAA or SSB approval) before documents can be produced to foreign regulators.[22] Clarke Tr. 2364:21-2365:19; Clarke Expert Report ¶ 52. At the same time, however, Professor Clarke agrees that the CSRC has the power to assert its authority and require

[22] Assuming, *arguendo*, that the meaning of the provisions was not clear, that would give Respondents even greater reason to act cautiously and seek clarification from their regulators, as they did.

notice and approval when foreign regulators request audit workpapers from China-based firms. *Id.* at 2361:20-2363:3, 2364:14-20; Clarke Expert Report ¶¶ 51, 54. He also readily concedes that if the CSRC asserted its authority, Respondents were not in a position to challenge it under Chinese law. Clarke Tr. 2362:23-2363:3. Thus, to reach his position, Professor Clarke must ignore this undisputed factual context and the extensive oral instructions issued by the CSRC here, and focus entirely on a narrow reading of isolated portions of Regulation 29. Professor Clarke himself acknowledges that such an approach to construing Chinese law is inadequate and incomplete.[23] Clarke Tr. 2396:22-2397:20 (agreeing that "an account of the formal provisions of Chinese law is not adequate as a description or a prediction of what actually happens in China"); *id.* at 2397:5-10 (agreeing that "[i]t could not be clearer that a citation to a provision of formal law is simply not sufficient to show that a practice or right actually exists in the Chinese legal system"); *id.* at 2397:14-20.

Indeed, the evidence demonstrates that the CSRC repeatedly and clearly has asserted its authority under these written laws, and Respondents may not produce documents to foreign regulators without its approval. That is dispositive as to whether CSRC approval is required under Chinese law.

Moreover, starting in at least June 2010, the SEC itself engaged the CSRC in an effort to obtain audit workpapers and other documents from within China. This was not a meaningless

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[23] Perhaps for this reason, Professor Clarke is alone in his view of Chinese written law, and on the other side of the issue from (1) Professors Tang and Feinerman (who he regards as qualified Chinese legal scholars), Feinerman Tr. 2369:13-17; Tang Expert Report ¶ 33; Tang Rebuttal Report ¶¶ 22-24, 31; Feinerman Rebuttal Report ¶¶ 4, 15, 19-26, (2) Linklaters (which has advised Respondents on the relevant Chinese laws for the better part of a decade), *see infra* note 34 and corresponding text, (3) Respondents' percipient witnesses (each of whom understood Chinese written law to require approval from the CSRC), *see, e.g.* Chao Tr. 1353:9-25 (during questioning from the Division: "Q: And you would you agree with me that [Regulation 29] also says that CPAs in China are strictly prohibited from sending those documents outside of China? A: Yes"); Wong, J. Tr. 2160:22-2161:10, 2208:15-25, and (4) even PCAOB Board Member Lewis Ferguson, Respondents Ex. 258, at 7; Respondents Ex. 259, at 11.

act by the SEC; it amounted to a recognition of the CSRC's authority in this area. Indeed, following the SEC's request, the CSRC promptly asserted its authority over the production of audit workpapers to the SEC and maintains that authority to the present day. Respondents Ex. 72A; Clarke Tr. 2362:14-2363:3 ("Q: And you're not questioning that, if the CSRC asserts its authority, that Respondents are not in a position to question that, right? A: They're not in a position to challenge it. Under Chinese law, they're not in a position to challenge it."). As its negotiations with the SEC continued throughout 2011 and 2012, the CSRC issued a series of oral and written directives to Respondents, requiring them to seek and obtain approval from the CSRC before producing documents abroad. *See supra* Section III.A; *see, e.g.*, Respondents Ex. 245A; Respondents Ex. 246A; Respondents Ex. 546A. Most recently, the CSRC has taken the lead in developing and deploying new procedures to facilitate the production of documents to foreign regulators. Indeed, pursuant to Article 7 of Regulation 29, the CSRC has asserted its coordinating role with respect to other relevant Chinese agencies. Tang Expert Report, Ex. 2, Item 15, ¶ 7; Tang Rebuttal Report ¶¶ 20-24; *see, e.g.*, Chiu Tr. 1778:12-24 (describing the CSRC's coordination with other government agencies regarding state secrets identified in the DTTC Client A workpapers); *id.* at 1779:6-14 (same). And the CSRC has explicitly described this coordinating role, including with respect to confidentiality issues, in correspondence with the SEC's Office of International Affairs. *See, e.g.*, ENF Ex. 266 (explaining that "[d]ue to the large amount and variety of the documents, the CSRC has to complete the review process together with other authorities.").[24]

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[24] *See also* ENF Ex. 252, at SEC_SUPP_AUDIT 0000019 (describing that the CSRC must "go through the necessary internal and external process"); ENF Ex. 270, at SEC_SUPP_AUDIT 0000047 (noting that if workpapers are "to be used by foreign regulators in legal proceedings, [they] must be approved by cross-border enforcement coordination meeting held by the CSRC and other Chinese government authorities....").

A key example of the CSRC's assertion of authority here is the written directives that it issued to Respondents in October 2011. Respondents Ex. 245A (letter from CSRC to DTTC (Oct. 11, 2011)); Respondents Ex. 246A (letter from CSRC to Respondents (Oct. 26, 2011); Respondents Ex. 546A (letter from CSRC to KPMG Huazhen (Oct. 17, 2011)). The Division and Professor Clarke misread the written directives, in large part because (again) they fail to consider critical context. They contend that the letters themselves do not establish any requirement that Respondents seek approval from the CSRC before producing documents to foreign regulators, but instead merely require that Respondents comply with existing law. ENF Pre-Hearing Brief at 4 ("Respondents claim that, in October 2011, the [CSRC] instructed them not to produce documents directly to the SEC. However, the CSRC letters that Respondents rely upon do not contain such an instruction."). As demonstrated above, CSRC approval would be required even under this faulty construction, since it was otherwise required by written Chinese law and a series of oral directives.

But the import of these directives is broader than that. The Division and Professor Clarke's construction is narrowly restricted to the final paragraph and concededly renders the letter redundant. *See* Clarke Tr. 2383:18-2384:20 (acknowledging that "under [his] interpretation," the "second sentence of the fourth paragraph," which includes the phrase "without authorization" is rendered "redundant"). When read in its entirety, the letter is clear on its face and sets forth three main statements: (1) Chinese laws, regulations, and provisions (explicitly including the Securities Law, discussed above), as well as applicable procedures, must be followed when documents are produced to foreign regulators; (2) foreign regulators must seek audit workpapers through cooperative mechanisms with Chinese regulators; and (3) it is illegal for Respondents to directly produce audit workpapers to foreign regulators "without

authorization," and legal liabilities will be imposed for doing so.[25] *See* Respondents Ex. 246A. Taken together, these statements clearly prohibit Respondents from producing any workpapers to foreign regulators without the approval of the CSRC, and require that such productions must be made through the CSRC (the entity responsible for cross-border securities regulatory issues).

Further, when read in context—and against the backdrop of the CSRC's assertion of authority over cross-border productions of audit workpapers and numerous oral directives—there is no question that this letter is a clear order that Respondents must not produce documents to foreign regulators without permission. Indeed, the fact that the CSRC took the rare step of confirming its position in writing underscores the CSRC's significant interest in this issue, and the severity of the punishment that would face any firm that disobeyed these directives. *See* Feinerman Expert Report ¶ 37; Ji. Tr. 2130:4-16. Professor Clarke, however, did not consider any of this critical context when interpreting the written directives from October 2011, and his interpretation is therefore rendered unreliable by his own standards. Clarke Tr. 2367:6-18, 2396:22-2397:20.

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25 During the hearing, the Division took issue with certain informal translations of the October 2011 directives. *See, e.g.*, Tr. 28:14-30:16. But as Professor Clarke himself explained, the original Chinese language is what matters, and any translations into English require judgment. Clarke Tr. 2382:15-16, 2386:8-12. Indeed, Professor Clarke's own report referenced a translation of the October 26, 2011 that erroneously omitted the phrase "without authorization," which Professor Clarke agrees clearly appears in the letter, and it attached a different translation that he later determined was inaccurate. Clarke Tr. 2374:22-2375:17. Thus, the important point is that Professors Tang and Feinerman and all of Respondents' Chinese-speaking witnesses read the letters to require approval from the CSRC, and, once again, Professor Clarke is alone in his view to the contrary. Clarke Tr. 2379:19-2380:7; *see, e.g.*, Tang Tr. 2414:7-18; Feinerman Expert Report ¶ 36 ("From the [October 26, 2011 letter from the CSRC], it should be abundantly clear that the Chinese government and securities regulatory authorities have taken the position that direct production of audit workpapers to foreign governments in either an administrative or judicial proceeding without approval of the Chinese government would be a violation of Chinese laws."). Further, as indicated above, the factual context of the oral directives issued at and before the October 10 meeting, which Professor Clarke expressly declined to consider, confirms Respondents' reading of the letter.

The Division also contends that the possibility that the workpapers contained state secrets is "unduly speculative," and therefore cannot support a finding that Respondents are prohibited from producing the workpapers directly to the SEC. ENF Pre-Hearing Brief at 43. And the Division further argues that even if the workpapers did contain State Secrets, because "Respondents have not undertaken appropriate steps necessary to obtain[ing] such a determination from the Chinese government," they did not act in good faith. *Id.* at 44. But the CSRC's new document screening and production process, which has been approved by the State Council of China, demonstrates that the CSRC is the primary regulator for audit workpaper productions—including when state secrets are involved. The new process entails CSRC notice to the relevant firm followed by that firm carrying out a screening review with the support of outside counsel. Leung Tr. 1476:1-14; George Tr. 1635:13-18; Yan Tr. 1924:1-7, 1925:19-25. The focus is to identify and redact state secrets or other sensitive information. Leung Tr. 1476:9-12; George Tr. 1635:18-21; Yan Tr. 1925:19-25. The documents are then transmitted to the CSRC with comments related to potentially sensitive information. Leung Tr. 1480:23-25; George Tr. 1635:22-1636:5. The adoption of this process, which centers around the CSRC, demonstrates that Respondents were correct to address any state secrets concerns with the CSRC itself.

Process aside, the Division also continues to ignore the fact that state secrets in fact have been identified in workpapers produced to the CSRC to date. *See, e.g.*, Chiu Tr. 1796:9-13 (stating that "[w]orking papers [for DTTC] Client A contained some state secret information"); *see also id.* at 1779:2-23, 1783:2-19, 1785:2-7, 1815:18-1817:3; Leung Tr. 1480:20-1482:8 (confirming that state secrets have been identified in the Client C workpapers). It also ignores that state secrets had been identified in the Longtop audit workpapers before the filing of the pre-

hearing briefs, which the Division certainly knew. ENF Ex. 339, ¶ 10 ("I found, after review, the Longtop Audit Workpapers contain information that has been affixed with state secret mark . . . ."). If Respondents had produced these documents directly to the SEC and without conferring with the CSRC, as the SEC proposed, *see* ENF Pre-Hearing Brief at 47, they would have violated Chinese criminal laws. Clarke Tr. 2397:21-25 (agreeing that unauthorized disclosure of state secrets can result in criminal penalties).[26]

At bottom, the record plainly contradicts the Division's repeated suggestion that Respondents could have produced at least some workpapers without Chinese government approval. That is in direct conflict with the Division's own Chinese law expert. Clarke Expert Report ¶ 14 ("Audit work papers are deemed archives by the State Archives Administration. Such archives may generally not be transferred abroad without approval."). Therefore, the SEC's suggested resolution, *i.e.*, sneaking the documents out of China without approval, violates not only Chinese criminal law but also its own expert's opinion on the proper procedures for producing documents abroad.

The hearing evidence thus established that, in addition to the dispositive oral directives, written Chinese law required Respondents to notify and seek approval from the CSRC.

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[26] Similarly, if Respondents had attempted to identify the state secret information without the guidance and screening procedures set by the CSRC, they would have taken on an "enormous risk" that the Chinese authorities could later disagree with Respondents' own assessment of what constitutes a state secret. Feinerman Rebuttal Report ¶ 10; *see also* Clarke Tr. 2398:6-14 (agreeing that "the fact that material is not marked a state secret does not guarantee that the authorities would not consider it a state secret"); Clarke Expert Report ¶ 22 (same). Given that such productions would have occurred in the context of an international dispute between the SEC and CSRC and in the face of explicit directions not to produce the documents, the risks are particularly intolerable.

3. Violation of These Laws and Directives Would Lead to Severe Punishment.

The record leaves no doubt that if Respondents violated Chinese law—and produced documents directly to the SEC in the face of explicit instructions to the contrary—the consequences could be severe, including possible dissolution of the firms and imprisonment for their personnel.

In fact, once again, the parties' experts are in agreement that the Chinese authorities could levy harsh penalties against Respondents for violating the explicit directives and written laws at issue here. Specifically, all the experts agree that the unauthorized disclosure of state secret information (which has been identified in every single production Respondents have made to the CSRC) would trigger criminal penalties.[27] Clarke Tr. 2397:21-25; Tang Tr. 2416:16-22, 2427:1-6; Feinerman Tr. 2542:18-21. In addition, all the experts agree that the Chinese authorities have the authority to suspend accounting firms from practice, revoke their licenses, or dissolve them altogether. *See, e.g.*, Tang Expert Report ¶¶ 68-79; Tang Rebuttal Report ¶ 3; Tang Tr. 2415:7-17, 2424:23-2425:5; Feinerman Expert Report ¶¶ 47-48; Feinerman Rebuttal Report ¶ 10; Clarke Tr. 2403:3-2405:11 (agreeing that China's financial authorities, including the MOF, "have the power in certain circumstances to dissolve or revoke the license of accounting firms," and "therefore, accounting firms need to worry about what the MOF thinks"); Clarke Rebuttal Report ¶ 23 (same). The Chinese authorities have taken such actions in the past, Tang Expert Report ¶ 34, and Professor Tang demonstrated in his report and testimony that

[27] Professor Tang also explained that the unauthorized production of audit workpapers to the SEC could expose Respondents to *criminal* penalties under Article 24 the Archives Law, among other provisions. *See, e.g.*, Tang Tr. 2423:4-2425:12. Neither the Division nor Professor Clarke provided any rebuttal to this point.

Chinese law authorizes such severe sanctions for violations of the exact laws and directives at issue in this proceeding. *Id.* at ¶¶ 68-73.

By contrast, Professor Clarke effectively punted. He emphasized that he did not "render an opinion on any kind of overall assessment of what the likelihood of sanctions in China would be under the circumstances of this case." Clarke Tr. 2406:9-14; *see also* Clarke Tr. 2404:13-20. Instead, he merely suggested that prior examples of dissolution involve "different sets of facts," Clarke Tr. 2405:19-2406:14, and that he is not aware of criminal State Secrets prosecutions involving audit workpapers. Clarke Tr. 2401:9-2402:6.[28] But these fine distinctions ignore that the risks to Respondents are substantially elevated here because of the "intersection of Chinese interests and foreign interests" that are presented. Feinerman Rebuttal Report ¶ 17 (explaining that "many of the most public State Secrets prosecutions in China involved such an intersection—individuals obtaining information on China interests, such as the steel industry, and sharing them with foreign actors"). Indeed, it would be truly unprecedented for Respondents to defy the direct instructions of their China regulators in the midst of an international dispute between those regulators and the SEC.

The witness testimony highlighted these serious risks and demonstrated Respondents' good faith and correct belief about the elevated risk of punishment. *See, e.g.*, Chao Tr. 1294:18-1295:3, 1296:17-22, 1301:9-15; Leung Tr. 1400:20-1401:5; Wong, D. Tr. 1859:10-16, 1897:9-1898:12; Yan Tr. 1910:25-1911:6, 1956:6-11. The CSRC and MOF explicitly

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[28] Professor Clarke's report unequivocally stated: "I do not know of actual cases, and the correspondence and Wells submissions of the Respondents have not offered cases, in which the work papers of accounting firms have been found to contain state secrets." Clarke Expert Report ¶ 22. But Professor Clarke later conceded at the hearing that he had been advised, prior to the submission of his report, that state secret information had been identified in the Longtop workpapers, and he "apologize[d] to all for not putting that in" his report. Clarke Tr. 2398:15-2402:6. Only at that point did Professor Clarke add his qualification that "[w]hen I meant cases, of course, I meant *criminal* cases." Clarke Tr. 2401:16-21 (emphasis added).

warned Respondents that their licenses could be revoked if they produced documents directly to the SEC. Leung Tr. 1432:19-22; Yan Tr. 1916:17-20, 1954:20-24, 1956:6-20; *see also* Chao Tr. 1314:17-23. Further, a number of witnesses expressed their fear of individuals being punished if their firms violated Chinese law and disobeyed the CSRC's and MOF's directives. *See, e.g.*, Chao Tr. 1314:5-10, 1315:14-24; Wong, D. Tr. 1898:8-12; Yan Tr. 2001:11-18. On such a record, uncontradicted by the Division, there is nothing speculative about the serious risk of punishment facing Respondents.

4. Possible Productions by Other Parties Do Not Alter the Outcome.

Based on conclusory, self-serving assertions rather than evidence, the Division argues that certain issuers, or U.S.- and Hong Kong-based successor or predecessor auditors, produced documents to the SEC without suffering any consequences. *See, e.g.*, Josephs Tr. 57:9-58:5; Rana Tr. 174:14-23, 187:8-192:14; Kaiser Tr. 374:2-375:5. The Division's apparent suggestion is that either Chinese law does not prohibit production of documents to the SEC, or these laws are not enforced (in which case it tacitly condones the violation of Chinese law). Clarke Expert Report ¶¶ 12, 16, 44; Clarke Tr. 2334:9-18, 2341:18-24, 2356:9-2357:14; 2358:22-2359:18.

But there is absolutely no support for either proposition. Indeed, the only evidence offered by the Division on this issue was general and conclusory statements by its own employees, who often reported what they were told by colleagues or third parties, and who, in any event, did not proffer any specific information about these productions. *See, e.g.*, Hubbs Tr. 480:2-22. The Division did not introduce into evidence either the produced workpapers themselves, or any other documents or evidence showing the manner in which the productions were made, if at all. The Division has also offered no evidence that the workpapers were created in China, or that they were produced from China. In short, the evidence presented by the Division was so vague that it is an insufficient basis on which to make any legal determinations.

However, there is one point that is abundantly clear: to the extent such productions involved the unauthorized transfer of archives (workpapers) or state secrets outside of China (as any production by Respondents undeniably would), they were in violation of Chinese law. Specifically, if the U.S.-based firms managed to obtain workpapers that were created in mainland China (and the Division has not introduced any evidence that is the case), those firms—and any affiliates or agents who assisted in removing the documents—violated Regulation 29. Article 6 of that Regulation mandates that "any archives, including workpapers, which are created in mainland China by the securities company and securities service institution providing relevant securities service in the course of any overseas issuance and listing of securities, shall be stored in mainland China." Tang Expert Report, Ex. 2, Item 15, ¶ 6. That Article further provides that "without the approval of the relevant in-charge authorities, such workpapers shall not be carried or shipped overseas, or delivered to overseas institutions or individuals through any means such as information technology." *Id.* The Division offered no evidence, and in fact did not even suggest, that any of the entities which they said produced workpapers ever obtained such approvals. Thus, any unauthorized productions by those entities violated Chinese law. That fact certainly does not relieve Respondents of their obligation to follow Chinese law, which even the SEC's expert admits requires approval before transporting workpapers created in China outside of the country. Clarke Tr. 2390:15-2391:15.

In any event, those other auditors were either U.S.- or Hong Kong-based—as the Division's own witnesses recognized[29]—and, to the knowledge of the witnesses, were not

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[29] Specifically, the evidence showed that:

- Client B's predecessor auditor, Crowe Horwath LLP, is based in California. Hubbs Tr. 549:11-13; *see also* Leung Tr. 1578:10-15; Respondents Ex. 2, at F-1 (Client B's 2009 Form 10-K).

licensed by the CSRC or registered with the MOF. *See* Leung Tr. 1578:13-1579:10. Simply put, accounting firms not based in China, and not registered with the CSRC or MOF, do not share Respondents' same regulatory concerns. *See* Feinerman Tr. 2564:22-2565:1; Leung Tr. 1592:15-1593:1. What evidence exists suggests that the documents were requested and produced from the United States, Rana Tr. 204:3-6, 206:7-18; Chang Tr. 700:2-4, or were produced from Hong Kong, Kaiser Tr. 374:22-375:2; Hubbs Tr. 480:10-14. Therefore, although the productions by other audit firms were presumably in violation of Chinese law, they took place outside of China and were not made by China-based firms.[30]

As to the issuers, the documents they produced are not explicitly defined as archives under Regulation 29. *See, e.g.*, Tang Expert Report, Ex. 2, Item 15. There is no dispute among the experts, however, that audit workpapers are archives, and the production of archives abroad requires approval from the Chinese government. Clarke Tr. 2390:15-2391:15; Tang Expert Report ¶ 60. Therefore, the issuers' production of non-archive material is not relevant to whether Respondents can legally produce materials that are indisputably "archives" without approval of the Chinese authorities.

Finally, beyond the limitations established by written Chinese law, Respondents were given explicit directives by Chinese governmental officials indicating that they could not

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- Client E's predecessor auditor, Patrizio & Zhao, is in New Jersey. *See* Rana Tr. 203:20-204:2. And GHP Horwath, Client E's successor auditor, is based in Denver, Colorado. *See* Rana Tr. 206:3-6.
- Client G's predecessor auditor, Frazer Frost LLP, is based in California. Chang Tr. 732:15-17.
- Client I's predecessor auditor, PKF Hong Kong, is based in Hong Kong. Kaiser Tr. 374:25-375:2.

[30] As described below in Section VI.C.3, it is now clear that Hong Kong firms that perform work in China must comply with PRC laws and regulations, and U.S.-based firms must obtain temporary licenses, from the CSRC, to perform audit work in the PRC.

produce documents directly to the SEC. *See* Section III.B.2 (section on oral directives); *see also* Chao Tr. 1372:13-18, 1390:12-18 ("But I know very clear, being a firm, the largest firm in China, being there at the meeting and being told very directly, the Ministry of Finance, who has got jurisdiction of all the accounting firms operating in China, I heard very clearly from both the MOF and the CSRC in terms of the directives."). There is no suggestion, however, that any of the other auditors or issuers that the Division now identifies were present at any meeting with Chinese officials when Respondents were explicitly instructed not to produce documents. *See* Section III.B.2 (section on oral directives). That does not mean, however, that such directives do not apply to these other firms: They do. Rather, this only demonstrates the importance of Chinese accounting firms conferring with the CSRC in order to understand their obligations prior to producing documents to a foreign regulator. Feinerman Tr. 2565:19-2566:1. And there is no doubt that had these firms contacted the CSRC, they too would have been directed not to produce documents directly to the SEC. Feinerman Tr. 2565:19-2566:1.

Ultimately, there is no way of knowing whether the Chinese authorities are actually aware of the productions by the issuers and the other audit firms, and the Division presented no evidence on that point. Nor is there any way to know if actions have already been taken against these entities. Feinerman Tr. 2565:2-7; *see also* Feinerman Tr. 2541:18-24. In China, it is quite possible they have already been reprimanded or sanctioned, but that information is simply not public. Feinerman Tr. 2565:2-7. Because the Division introduced no evidence as to whether any of the audit firms or issuers that produced documents have or have not been punished, the Court is left with mere conjecture. And that conjecture is far from sufficient to satisfy the Division's burden.

B. Respondents Are Not Responsible for the Current Legal Impediments, and Have Undertaken Extensive Efforts to Facilitate Production.

Effectively acknowledging the existence of Chinese legal impediments, the Division has suggested that Respondents are somehow responsible for the current legal impediments, *see* ENF Pre-Hearing Brief at 48 ("[I]t was DTTC's choice, and not its obligation, to seek pre-clearance from the CSRC prior to responding to the Request."), and "made insufficient efforts to achieve compliance with the [Section 106] requests in light of Chinese law." *Id.* at 42. The hearing evidence completely refutes these contentions, and instead demonstrates Respondents' good faith.

1. The SEC Itself First Contacted the CSRC About Its Desire to Obtain Audit Workpapers from Respondents.

It is undisputed that the SEC itself made first contact with the CSRC concerning its attempt to obtain audit workpapers from Respondents. Josephs Tr. 91:14-17 ("Q: As far as you know, the first to contact the CSRC about the Client A workpapers was the Securities and Exchange Commission, not my client, Deloitte? A: Yes. That's true."). In June 2010, the SEC requested the CSRC's assistance in obtaining the DTTC Client A workpapers. ENF Ex. 192. In turn, on July 6, 2010, the CSRC requested the audit workpapers from DTTC, and DTTC promptly produced them to the CSRC in just over two weeks. Respondents Exs. 72A, 92A. In March 2011, the SEC issued the DTTC Client A Section 106 request, ENF Ex. 127, and—having already produced the workpapers to the CSRC nine months earlier—DTTC understandably and appropriately contacted the CSRC to determine whether it could make a direct production to the SEC. There is thus no support for the Division's suggestion that DTTC created the impasse by

conferring with the CSRC about the Section 106 request regarding DTTC Client A.[31] Due to the SEC's own actions, the CSRC was fully involved in this process long before DTTC ever contacted the CSRC about the Section 106 request.

In any event, as demonstrated above, Respondents were legally required to notify the CSRC about the Section 106 request and to obtain its approval before producing the documents to the SEC. *See* Section III.A. Legal requirements aside, there is certainly no basis to find that contacting a home country regulator in these circumstances would constitute bad faith. As explained by Professors Feinerman and Tang, no reasonable Chinese audit firm would respond to a foreign regulator's document request without consulting with the CSRC. Feinerman Tr. 2515:7-14; Tang Tr. 2411:6-2416:22; Feinerman Expert Report ¶ 44; Feinerman Rebuttal Report ¶ 4; Tang Expert Report ¶ 44; Tang Rebuttal Report ¶¶ 3, 4, 24, 46, 47. Once again, Professor Clarke takes no position on the reasonableness and prudence of consulting with the CSRC about the request in these circumstances. Clarke Tr. 2357:18-2360:7 (noting that he has "far too little information to make a judgment" about "whether Respondents acted responsibly in approaching the CSRC").[32] It is thus factually inaccurate for the Division to suggest that Respondents' conduct is somehow responsible for the legal impediments in China, and in any event, conferring with the CSRC was both legally required and the only reasonable course.

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[31] Throughout this proceeding, the Division has made much of the CSRC's alleged lack of responsiveness to its June 2010 request for assistance and purported unwillingness to cooperate and produce the DTTC Client A workpapers. *See, e.g.*, Arevalo Tr. 944:14-17, 952:13-17, 970:13-16, 1066:24-1067:11. However, if that position were correct, it completely undermines the Division's other argument that DTTC is somehow responsible for the impediments as a result of contacting the CSRC nearly a year later.

[32] Instead, he merely opines that notifying and seeking approval from the CSRC is not required by any written law. Clarke Expert Report ¶¶ 12, 16, 44; Clarke Tr. 2356:9-2357:14; 2358:22-2359:18. That is wrong as a matter of law. Moreover, the evidence at the hearing demonstrated that Respondents were advised by their PRC counsel that they were obligated to notify the CSRC of the SEC and PCAOB requests—a position that the CSRC itself reaffirmed at subsequent meetings. *See, e.g.*, Leung Tr. 1409:4-1410:24; George Tr. 1602:4-18; Chao Tr. 1299:1-11 (stating that the CSRC indicated to PwC Shanghai that it had "done the right thing in terms of working through [the CSRC].").

2. Although the CSRC and MOF Instructed Respondents Not to Produce Documents Directly to the SEC, Respondents Undertook Extensive Efforts to Facilitate Production.

Despite facing these legal impediments, Respondents have made extensive efforts to facilitate the production of the requested audit workpapers to the SEC, or otherwise cooperate in the underlying investigations.

As noted, the first time the CSRC requested any workpapers from any of the Respondents, DTTC promptly produced the DTTC Client A workpapers to the CSRC within the same month they were initially requested. Respondents Ex. 72, at DTTC-CS-000098 (July 6, 2010 request from CSRC to DTTC for DTTC Client A workpapers); Respondents Ex. 74 (confirming July 23, 2010 delivery of DTTC Client A workpapers to CSRC). DTTC made this production with the understanding and intent that the workpapers would be provided to the SEC. George Tr. 1637:17-23 ("Having worked with the new procedures and delivered the working papers to the CSRC, I fully expect[ed] those working papers [would] be delivered by the CSRC to the SEC").

Once the Division began to issue requests for the direct production of documents, each of the Respondents repeatedly requested and attended meetings with the CSRC and MOF to determine if they could produce documents directly to the SEC or otherwise facilitate a regulator-to-regulator production. *See, e.g.*, Chao Tr. 12987:25-1298:14, 1309:24-1310:4; Leung Tr. 1411:7-22, 1467:8-17; George Tr. 1614:7-17; Wong, D. Tr. 1872:22-1873:19, 1877:9-20. The Chinese regulators remained steadfast in their opposition to such a direct production on the SEC's required terms, but Respondents nonetheless continued their dialogue throughout the relevant time and kept the Division apprised of relevant developments. In particular, in August 2011, DTTC explicitly requested, in writing, that the CSRC reconsider its position (explained to

DTTC just four months prior) that direct productions to the SEC were prohibited.[33] Respondents Ex. 116A. Specifically, DTTC's letter notified the CSRC of the Wells notice it had received regarding DTTC Client A, and stated:

> Because of the seriousness of the SEC staff's recommendation and the potential consequences should the SEC authorize an action against DTTC and move forward to preclude DTTC from auditing Chinese companies listed on United States exchanges, *we respectfully request that you reconsider your earlier decision and authorize DTTC to produce its 2009 [DTTC Client A] audit working papers (or a copy thereof) directly to the SEC in the United States.*

Id. (emphasis added). The CSRC did not change its position. George Tr. 1613:7-9. Nonetheless, DTTC continued its efforts to facilitate a production to the SEC, including through almost daily communications with Division Staff in early 2012. *See* Josephs Tr. 77:4-10 (during cross-examination by Mr. Warden, "Q: And there was a period of time in March and April of 2012 that you and Ms. Friedman and I were talking almost every day -- A: Yes. Q: -- about Deloitte and about trying to get documents out of China; is that correct? A: That is correct.").

Similarly, in an attempt to facilitate a production to the SEC, KPMG Huazhen instructed its local counsel to contact the SSB and SAA in the respective province or region in which Clients D and F operated in order to conduct the necessary assessment. Those agencies informed KPMG Huazhen that "they would not accept an application from a non-governmental entity such as KPMG Huazhen and that the request must be submitted by a government entity or another PRC regulatory authority." Respondents Ex. 551A; Wong, J. Tr. 2178:11-2179:9.

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[33] This is yet another example where the evidence directly refutes an unequivocal statement in the Division's pre-hearing brief. Specifically, the Division contended that "Respondents' correspondence does not demonstrate that they sought from Chinese authorities a waiver that would allow them to produce the requested documents directly to the SEC. There is no written request for a waiver to the CSRC, nor is there any request to the State Archives Administration ('SAA') that it approve the firms' production of materials deemed 'archives.'" ENF Pre-Hearing Brief at 51-52. But as noted above, the record directly contradicts that statement.

KPMG Huazhen reported these responses to the CSRC, which confirmed that was the appropriate response from the SSB and SAA. Respondents Ex. 551A, at 3; Wong, J. Tr. 2178:11-2179:9. KPMG Huazhen also asked Clients D and F for their consent to produce documents. The former indicated that their counsel advised that PRC law prohibited KPMG Huazhen from producing the documents and the latter never responded. Wong, J. Tr. 2163:9-2165:9; Respondents Exs. 540, 543.

Other Respondents attempted to produce documents or information to the Division, or otherwise cooperate with it, to the extent permitted under Chinese law. Each time Respondents received a request from the SEC or CSRC, they went through the process of reviewing documents and preparing them for production as soon as possible, which involved extensive efforts. *See, e.g.*, Respondents Ex. 396, at SEC_HO-11604_Wells_0000448; Chui Tr. 1774:5-1779:23, 1782:9-1785:10; Wong, D. Tr. 1869:20-1870:2; Respondents Ex. 402, at 1. For example, PwC Shanghai undertook extensive work to expeditiously compile and create, in English, information requested by the Division, working nights, weekends, and public holidays over a period of three to four weeks. Kaiser Tr. 421:18-422:13, Wong, D. Tr. 1856:8-22; Respondents Ex. 396, at SEC_HO-11604_Wells_0000448. The firm made this considerable effort based on its desire to assist the Division to the greatest extent possible. Chao Tr. 1291:16-1292:2; Wong, D. Tr. 1856:23-1857:8. PwC Shanghai also understood that the CSRC might need to review the assembled materials in advance of any production to the SEC. Wong, D. Tr. 1856:23-1857:8. PwC Shanghai then provided the CSRC with the materials that it had created and compiled in response to the Division's request, along with underlying workpapers supporting the newly created chronologies. Wong, D. Tr. 1863:4-1864:6; Respondents Ex. 394A.

Furthermore, EYHM produced to the SEC certain documents (including invoices and an engagement letter) that did not constitute restricted archive workpapers, Hubbs Tr. 484:2-15, and several of the Respondents offered to produce the requested documents to the CSRC. *See, e.g.*, Leung Tr. 1451:6-17, 1461:4-15, 1463:20-25, 1468:19-25; Respondents Exs. 25A, 33A. Likewise, PwC Shanghai facilitated calls between its engagement partners, risk management personnel and counsel for the relevant matters and the SEC to discuss its audit procedures in general and in a way that would not violate Chinese law. Wong, D. Tr. 1839:22-1843:1 (Client H), 1851:17-1853:5 (Client I); Respondents Ex. 371. During these lengthy calls, PwC Shanghai answered questions from the Division regarding its audit procedures in several areas in which the Division expressed interest. London Tr. 867:9-18, 887:1-8; Wong, D. Tr. 1841:23-1842:9. At the end of the call regarding Client H, the participants from the Division thanked PwC Shanghai for its assistance and stated that the Division would send PwC Shanghai a follow-up request for information. London Tr. 888:20-889:1; Wong, D. Tr. 1842:10-1843:6. The Division did not do so. Wong, D. Tr. 1843:2-6. Indeed, prior to the time of issuing its Section 106 request related to Client H some seven months after first contacting PwC Shanghai, while the Division interacted with PwC Shanghai representatives on multiple occasions and asked for and obtained information as requested, it never once asked for the production of Client H workpapers.

Most recently, Respondents have committed substantial resources to completing the screening process that is part of the CSRC's new procedures, with the intention that such efforts will allow for production to the SEC. *See, e.g.*, George Tr. 1635:11-1637:23 (testifying that the Longtop, DTTC Client A, and Client G workpapers were produced to the CSRC in accordance with the new procedures implemented by the PRC government); Chiu Tr. 1784:2-11, 1791:3-1792:22 (testifying that DTTC put the Longtop and DTTC Client A documents through the new

PRC process, and devoted 9,000 hours to the process); Respondents Ex. 632A (July 3, 2013 request from the CSRC to EYHM for Client C workpapers); Leung Tr. 1579:17-1581; Respondents Ex. 649A (confirming July 22, 2013 delivery of Client C workpapers to CSRC); Respondents Ex. 650A (July 19, 2013 request from CSRC to KPMG Huazhen for Client D and F workpapers); Yan Tr. 1927:1-13 (testifying that a team of people has started to review the materials); Wong, J. Tr. 2192:18-24 (testifying that KPMG started preparing documents for production to the CSRC).

Taken together, these actions demonstrate beyond any genuine dispute Respondents' willingness to take any legally permissible action to assist in the facilitation of producing documents to the SEC. There is nothing more that Respondents could reasonably do to produce the documents in this context. Such extensive good faith efforts to facilitate production and otherwise cooperate are entirely inconsistent with any alleged "willful refusal."

C. Respondents' Registration with the PCAOB Cannot Possibly Support a Finding of "Willful Refusal."

Respondents' good faith is also demonstrated by the indisputable evidence that they have long been transparent about the potential Chinese legal impediments to producing documents directly to U.S. regulators—a fact that cannot possibly support a finding of willful refusal. When Respondents first applied for registration with the PCAOB in 2004 and 2006, each of the Respondents declined to sign Item 8.1 on their PCAOB registration form, which requested their unqualified consent to produce documents to the PCAOB upon request.[34] They also provided extensive legal opinions that explained that Chinese law prevents them from

[34] *See* Respondents Ex. 205, Item 8.1, Ex. 99.2 (DTTC Application for PCAOB Registration (April 6, 2004)); Respondents Ex. 40, Item 8.1, Ex. 99.2 (Dahua Application for PCAOB Registration (Sept. 25, 2005)); Respondents Ex. 1, Item 8.1, Ex. 99.2 (EYHM Application for PCAOB Registration (May 25, 2004)); Respondents Ex. 365, Item 8.1, Ex. 99.2 (PwC Shanghai Application for PCAOB Registration (Apr. 26, 2004)); Respondents Ex. 513, Item 8.1, Ex. 99.2 (KPMG Huazhen Application for PCAOB Registration (Apr. 26, 2004)).

providing such "full" cooperation with document requests from overseas.[35] However, Respondents also indicated they would cooperate with any requests to the fullest extent permitted by applicable law.[36] Fully advised of these legal impediments, the PCAOB made the decision to approve each of Respondents' registration applications. ENF Exs. 6-10.

In the years following their registration, Respondents have continued to disclose to the PCAOB—and the market more broadly—the legal impediments they face in China. ENF Exs. 12-26 (Respondents' Form 2s). Indeed, the record clearly establishes that Respondents have been open and transparent with the U.S. regulators for nearly a decade.[37] *See, e.g.*, George Tr. 1619:15-23, 1684:2-15 ("[W]e've had so many touch points where DTTC has been very openly and transparently communicating with U.S. regulators about the impediments that it faces to producing directly to U.S. regulators."), 1715:12-18; Ji Tr. 2104:7-14; Wong, J. Tr. 2139:2-13.

Lacking any actual evidence that could establish a "willful refusal," the Division attempts to distort Respondents' transparency into evidence of bad faith. *See* ENF Pre-Hearing Brief at 51 ("Respondents knew, no later than 2006, when they were all registered with the

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35 *Id.*

36 *Id.; see also infra* note 44.

37 The SEC attempted to create an issue out of the fact that Respondents' Section 106(d) consents did not reference these Chinese legal impediments, but that is a red herring. *See* ENF Exs. 165A, 337; *see, e.g.*, George Tr. 1682:14-1684:23; Chao Tr. 1349:24-1351:10; Leung Tr. 1515:10-1518:20. Those documents related solely to service of process, and there is simply no reason Respondents would have referenced the potential legal impediments to document productions (again). Chao Tr. 1347:6-1349:1; George Tr. 1680:15-1688:10. Thus, consistent with the Section 106(d) consents, none of the Respondents is contesting service of the underlying Section 106 requests in conformity with the terms of the consents. Ultimately, any suggestion that, at the time it issued its Section 106 requests, the Division was not fully apprised of potential foreign legal impediments to obtaining audit workpapers abroad (including, but not limited to, in China) is fantastical. Just weeks after service of the DTTC Client A Section 106 request, Chairman Schapiro wrote to Congress explaining that "[i]n many jurisdictions, the SEC can directly access witnesses and information to further its investigations. However, some jurisdictions, such as the PRC, view such direct efforts as a possible violation of sovereignty and/or national interest, which may be expressed informally (as is done by the CSRC) or embodied in law or agreement." Respondents Ex. 241, at 6-7; *see also supra* at p. 12 (describing the SEC Chief Accountant's testimony to Congress before the passage of Dodd-Frank concerning "potential conflicts of law" in requesting audit workpapers from abroad).

PCAOB, that their production obligations under U.S. law could potentially conflict with Chinese law. Respondents cannot now claim that they have acted in '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."). This argument fails for multiple reasons.

First, at the time Respondents registered with the PCAOB, it was not at all clear that the inability to produce audit workpapers to the SEC would constitute a violation of law. The original version of Section 106 (passed in 2002) did not affirmatively require foreign accounting firms to produce documents to the SEC upon request. See 15 U.S.C. § 7216(b) (2002), amended by P.L. 111-203, Title IX, Subtitle B, § 929J, Subtitle I, § 982(g) (2010). It merely provided that foreign accounting firms were "deemed to have consented" to the production of documents. *Id.* It was not until 2010, years after Respondents registered, that Dodd-Frank amended Section 106 to state plainly that foreign accounting firms "shall comply" with any request by the SEC or the PCAOB, 15 U.S.C. § 7216(b) (2010), and that "willful refusal" to produce documents constitutes a violation of SOX. 15 U.S.C. § 7216(e). By this time, a number of the client engagements at issue, including DTTC's Client A and Client G engagements and KPMG Huazhen's's Client F engagement, had already begun.

Thus, when Respondents first registered with the PCAOB, it was plainly not the case that Respondents "knew" that their "production obligations under U.S. law could conflict with Chinese law" or that they could "land . . . in precisely the circumstances in which they now find themselves." *See* ENF Pre-Hearing Brief at 51.[38]

Second, the Division ignores that the PCAOB's and Respondents' actual, shared expectation was not that Respondents would find themselves in the middle of a conflict of law,

[38] As discussed below, Respondents were objectively reasonable in believing that their actions would not violate U.S. law even under Section 106's current formulation. *See infra* Section V.

but instead that any obstacles to production would be resolved on a sovereign-to-sovereign basis. *See* Respondents Ex. 607, at 1-2; George Tr. 1630:24-1633:13 ("We presumed, I think, that stakeholders in all of this, in particular the regulators working cooperatively together, would develop the platforms that would enable effective cross-border regulation to take place."); Leung Tr. 1506:5-12.

After the enactment of SOX, the potential registration of foreign accounting firms facing legal impediments in countries around the world was a significant issue facing the PCAOB and SEC.[39] To address this issue, the PCAOB and the Commission engaged in a lengthy study and received extensive submissions and comment letters. *See* Respondents Ex. 202. Two such submissions were made by the Linklaters law firm on behalf of Respondents' network firms in March 2003 and January 2004. *Id.* Respondents Exs. 197, 202. Those submissions describe laws in the EU, UK, Japan, France, Germany, Spain, Brazil, Israel and Switzerland that prohibited (and continue to prohibit) accounting firms from producing documents based on grounds of data privacy, confidentiality and official secrets, among others.[40] The two submissions urged that an exception to the proposed requirement obligating non-U.S. firms to produce any documents requested by the PCAOB be made to allow firms located in

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[39] China's restrictions are not unique in this regard. Firms from over fifty jurisdictions faced similar restrictions in their home countries and took a similar approach to registration. These countries include: Argentina, Australia, Austria, Bahamas, Bahrain, Belgium, Bermuda, Bolivia, Brazil, Canada, Cayman Islands, Chile, China, Colombia, Costa Rica, Cyprus, Czech Republic, Denmark, Finland, France, Germany, Greece, Hong Kong, Hungary, India, Ireland, Isle of Man, Israel, Italy, Jamaica, Japan, Jersey, Kazakhstan, South Korea, Luxembourg, Malta, Mexico, Netherlands, New Zealand, Norway, Panama, Papua New Guinea, Paraguay, Poland, Portugal, Romania, Russian Federation, Singapore, Slovakia, South Africa, Spain, Sweden, Switzerland, Taiwan, Ukraine, and the United Kingdom. *See* www. pcaobus.org; ; *see also* Respondents Exs. 309-364.

[40] For example, the March 2003 memorandum pointed out that in situations involving breaches of data privacy laws applicable in the EU and UK, the firms would be exposed to "both criminal and civil sanctions, including regulatory fines and individual claims for damage." Respondents Ex. 197, at 5. Likewise, the memorandum notes that in the UK, Germany and Switzerland, violation of the official secrets law could subject violators to criminal sanctions. *Id.* at 17.

countries where such conflicts existed to register with the PCAOB while efforts were made to overcome those issues. Moreover, the January 2004 submission specifically proposed that one method for overcoming such obstacles was the "use of other regulators."[41]

Ultimately, the PCAOB and the Commission adopted an approach that was consistent with the Linklaters proposals and other similar submissions.[42] Respondents Ex. 200. Indeed, as the PCAOB subsequently explained:

> In some non-U.S. jurisdictions, however, asserted legal restrictions or objections of local authorities pose unresolved obstacles to PCAOB inspections. From 2004 to the present, the Board has approved registration applications of many firms in those jurisdictions without raising the inspection obstacle as a potential basis for disapproval. *This practice was rooted in a belief that the PCAOB and authorities in those jurisdictions would, working cooperatively, overcome any obstacles to registered firms' compliance with PCAOB inspection demands for documents and information, and would do so without undue delay. . . .*

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[41] *See* Respondents Ex. 202. The January 2004 Submission explained, as an example, that "in general, the laws of most EU member States permit the disclosure of personal data to local regulators" and that requests made by U.S. regulators directed to their foreign counterparts could enable the firms to provide requested data without violating the data privacy laws in the EU, UK and elsewhere. *Id.* at 8.

[42] In its July 16, 2003 "Order Approving Proposed Rules Relating to Registration System," the SEC explained in a section entitled "Impact on Non-U.S. Accounting firms":

> "The Board has taken an important step in its mandate under the Act by proposing rules regarding registration of non-U.S. audit firms that prepare, issue, or play a substantial role in the preparation or issuance of, audit reports relating to U.S. public companies. This step has raised concerns in the international community, and the Board has made efforts to address those concerns, through its roundtable meeting in March, through its public comment process and through meetings and discussions with foreign regulators. *In response to these concerns, the Board made significant accommodations in its proposal, especially with regard to non-U.S. accounting firms, including changes eliminating the potential conflicts of law raised by the registration system, narrowing the scope of information to be provided, and extending the deadline for foreign firms to register.*
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> * * *
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> "*In this regard, we applaud the Board's initiative to work with its foreign counterparts to find ways to accomplish the goals of the Act without subjecting foreign firms to unnecessary burdens or conflicting requirements.*"

Respondents Ex. 200 at 3-4 (emphasis added).

Respondents Ex. 607 (emphasis added). Using this approach, the PCAOB approved registration applications submitted by firms located in numerous countries (not just China) that were unable to sign the consent set forth in Item 8.1 of Form 1.[43] *See* Respondents Ex. 602.

Respondents shared this exact same expectation with the PCAOB when they applied to register with it. *See, e.g.*, George Tr. 1627:22-1628:9, 1631:2-7; Leung Tr. 1503:5-12; Wong, J. Tr. 2162:24-2163:5. Respondents certainly did not seek to avoid production obligations, but rather reasonably believed their workpapers would be made available to the PCAOB and SEC via cooperative arrangements among regulators. *See, e.g.*, George Tr. 1630:24-1631:7. Indeed, Respondents committed to facilitate that process by using reasonable efforts to obtain consent from their home country regulator,[44] and that is exactly what they have done. *See, e.g.*, George Tr. 1622:14-22, 1626:4-8, 1627:9-18, 1658:1-4; Wong, J. Tr. 2163:23-2164:4; *see also* Wong, D. Tr. 1852:4-9.

Critically, the PCAOB's and Respondents' shared expectation has proven well-founded: the PCAOB has negotiated a Memorandum of Understanding regarding enforcement

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[43] When approving their registrations, the PCAOB sent letters to Respondents explaining that the legal impediments identified in their applications did not relieve them of the responsibilities to comply with Board demands. ENF Exs. 6-10. Consistent with the widespread nature of such legal impediments, these letters were not unique to Respondents; they were form letters, signed by the same person at the PCAOB, and generally provided to foreign firms that checked the "LC" (Legal Conflict) box and declined to provide unqualified consent to produce documents. *See* Respondents Exs. 563, 564. In any event, notwithstanding the PCAOB's technical reservation of authority in these letters, the PCAOB and SEC have given every indication that foreign firms like Respondents would not be placed in the middle of conflicting laws and instead regulator-to-regulator solutions would be achieved. Indeed, even when the PCAOB modified its position on registrations in October 2010, it did so prospectively only and took no action against existing registered firms that were prohibited from producing documents directly to the PCAOB. Respondents Ex. 607. The PCAOB did so despite the fact that in each year in which Respondents filed their annual Form 2 reports, they continued to highlight for the PCAOB and the public the legal impediment issue. The PCAOB never responded in any fashion, let alone with an effort to deregister any of the firms.

[44] Respondents Ex. 205, Ex. 99.2, at 3, ¶ 3.2; Respondents Ex. 40, Ex. 99.2, at 3, ¶ 4.2; Respondents Ex. 1, Ex. 99.2 Ex. 99.2, at 2, ¶ 3.2; Respondents Ex. 365, Ex. 99.2, at 3, ¶ 3.2; Respondents Ex. 513, Ex. 99.2, at 2, ¶ 3.2.

cooperation with the CSRC and MOF, Respondents Ex. 273, and the CSRC is currently in the process of producing workpapers to the SEC and PCAO. *See, e.g.*, Respondents Ex. 632A (July 3, 2013 request from the CSRC to EYHM for Client C workpapers); Leung Tr. 1579:17-1581; Respondents Ex. 649A (confirming July 22, 2013 delivery of Client C workpapers to CSRC); Respondents Ex. 650A (July 19, 2013 request from CSRC to KPMG Huazhen for Client D and F workpapers); Yan Tr. 1927:1-13 (testifying that a team of people has started to review the materials); Wong, J. Tr. 2192:18-24.

Third, during the hearing, the Division suggested that whatever their expectations upon registration, once faced with conflicting demands, Respondents somehow made a voluntary "choice" to comply with Chinese law rather than U.S. law. *See, e.g.*, Chao Tr. 1358:7-17; Leung Tr. 1522:12-24; George Tr. 1715:6-1716:18, Wong, D. Tr. 1890:14-1891:4; Wong, J. Tr. 2265:19-2266:22. But no such "choice" was ever made, *id.*, and this cannot be evidence of bad faith. *Id.* Respondents explained in their registration applications that they may well be unable to produce documents directly to U.S. regulators.[45] It was the PCAOB's decision (with SEC oversight) whether to approve Respondents' applications under such circumstances—and it did so. ENF Exs. 6-10; *compare Dagong Global Credit Rating Co.*, Securities Exchange Act Rel. No. 62968 (Sept. 22, 2010) (denying application under separate statutory scheme due solely to doubts that applicant could comply with document production and similar obligations). When the Section 106 requests were made, Respondents found that they were unable to produce the documents—just as they had previously disclosed. They were required to comply with their

[45] *See supra* note 34 and accompanying text.

home country laws. In the face of the serious penalties for violating their home country laws, there was no meaningful "choice" to comply or not.[46]

At bottom, there is simply no basis to conclude that Respondents' transparency when registering with the PCAOB establishes a "willful refusal" where: (1) at the time of Respondents' registration, Section 106 did not, in fact, make clear that Respondents' "production obligations under U.S. law could conflict with Chinese law"; (2) Respondents shared the PCAOB's expectation that a regulator-to-regulator approach would provide for the production of audit workpapers to U.S. regulators (which the PCAOB has, in fact, achieved); and (3) when Respondents were nonetheless faced with conflicting requirements, they had no choice but to comply with the Chinese laws they had disclosed nearly a decade before.

D. The Evidence is Clear that Respondents Have Nothing to Hide and Would Produce the Documents Directly to the SEC If Permitted Under Chinese Law.

Ultimately, the record demonstrates that Respondents have nothing to hide and would promptly produce the requested documents directly to the SEC if permitted under Chinese law.

Contrary to what the Division's attempt to permanently ban Respondents from practice might suggest, in most instances Respondents were the very entities that identified and

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[46] During the hearing, the Division engaged in semantics and tried to press a number of lay witnesses (many for whom English was not their primary language and none of whom were lawyers) into testifying that they "chose" not to comply with U.S. law. Leung Tr. 1522:12-24 ("Well, the firm did not have the choice. We were told by the PRC regulator that we should not directly provide working paper to the foreign regulators"); George Tr. 1716:14-18 ("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 no decision to be made. We have no choice in all this"); Wong, D. Tr. 1900:15-20 ("I don't actually think of it as a choice that was being made either way. I don't think we had a choice. We had a decision -- we made a decision to abide by Chinese laws, that is correct, but I wouldn't term it as a choice that we had. I don't view it as a choice"). But regardless of any such lay testimony, the U.S. Supreme Court has made clear that Respondents did not have a meaningful "choice" about whether to comply with their home country's law. *Societe Internationale*, 357 U.S. at 211 (holding that plaintiff's noncompliance with a discovery order because of foreign legal impediments was "due to *inability* fostered neither by its own conduct nor by circumstances within its control") (emphasis added).

reported the issues that have become the focus of the Division's investigations. The evidence shows that Respondents were properly discharging their role as auditors and, in doing so, raised important questions that led the SEC to open its investigations. *See, e.g.*, Chang Tr. 712:1-714:11, 716:24-717:15 (acknowledging that DTTC identified significant issues at Client G, raised them to the audit committee, was fired for raising those issues, and the SEC opened an investigation in light of DTTC's revelations); ENF Ex. 92, at Item 4.01 (SEC filing indicating problems DTTC identified with Client G). When appropriate, Respondents contacted the clients' audit committees, issued Section 10A letters, and resigned as auditors.[47] For example, it is uncontested that both of the relevant engagements undertaken by PwC Shanghai ended because PwC Shanghai raised concerns about certain issues and pushed to expand the scope of its audits and/or internal investigations by the client, Wong, D. Tr. 1833:2-14, 1835:17-25, and that PwC Shanghai's departure from the engagements caused Client H and Client I to make substantial public disclosures regarding PwC Shanghai's concerns, Respondents Ex. 380, at 103-04; Respondents Ex. 407, at 2. Indeed, in certain instances, the Division's own witnesses acknowledged that its investigations were triggered and greatly assisted by Respondents' actions. *See, e.g.*, Chang Tr. 714:8-11, 717:6-12 ("Q: And it looks like the issues, the questions that Deloitte raised were critically important, right? A: Correct. Q: Their work was very valuable to you, wasn't it? A: Yes.").

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[47] *See, e.g.*, Leung Tr. 1406:5-8 (EYHM sent 10A letters to Clients B and C), 1404:19-23 (EYHM resigned as Client C auditor); Hubbs Tr. 502:5-504:13 (SEC testimony regarding the rarity and issuance of a 10A letter); Respondents Ex. 405 (resignation letters from PwC Shanghai to Client I); Kazon Tr. 761:17-22 (KPMG Huazhen resigned from Client D); Boudreau Tr. 791:3-6 (KPMG Huazhen resigned from Client F); ENF Ex. 54 (10A letter from EYHM to Client B); Respondents Ex. 407 (SEC filing memorializing PwC Shanghai's resignation as Client I's auditor); Wong, J. Tr. 2146:18-2150:6 (KPMG Huazhen resigned from Clients D, E, and F audits because of failures by the company to adequately complete investigations deemed necessary by KPMG Huazhen); Wong, D. Tr. 1833:2-1835:25 (PwC Shanghai was terminated from Client H due to disagreements about the need for certain investigations and resigned from Client I because of disagreements regarding appropriate remedial measures).

Further, although prohibited from producing documents directly to the SEC, Respondents promptly produced documents to the CSRC each time they were requested to do so, and their intent and expectation was that those documents would be made available to the SEC. *See, e.g.*, Respondents Ex. 72, at 2 (July 6, 2010 request from CSRC to DTTC for DTTC Client A workpapers); Respondents Ex. 74 (confirming July 23, 2010 delivery of DTTC Client A workpapers to CSRC); George Tr. 1637:11-16 (testifying that the Client G workpapers were produced to the CSRC in July 2013); Respondents Ex. 632A (July 3, 2013 request from the CSRC to EYHM for Client C workpapers); Leung Tr. 1579:17-1581:18; Respondents Ex. 649A (confirming July 22, 2013 delivery of Client C workpapers to CSRC).[48]

These facts demonstrate Respondents' sincere desire to comply with their obligations as accounting firms. And they belie any suggestion that Respondents—who identified and reported the issues under investigation—have any reason or desire to avoid producing documents other than their obligation to comply with Chinese law.[49]

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[48] Notably, the CSRC has instructed that its new screening process for redaction of state secrets may not be used by the firms to withhold documents that are unfavorable to the auditors or reflect deficiencies. *See* Chiu Tr. 1789:4-90:9.

[49] With no actual evidence of bad faith, the Division attempted at the hearing to seize on KPMG Huazhen's correspondence with the CSRC as an issue. But the fact that KPMG Huazhen (with the involvement of its U.S. counsel, Mr. Geoffrey Aronow, who currently serves as Chief Counsel and Senior Policy Advisor in the SEC's Office of International Affairs, *see* Wong, J. Tr. 2264:17-20, 2279:21-24; http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370539765965) sought to add a few words to the CSRC written directive has no bearing on Respondents' good faith. ENF Ex. 335A, at 2. Apart from the oral directives which themselves were binding, the evidence shows that KPMG Huazhen proposed a small edit to one line of the written directive, which KPMG Huazhen believed would make the letter even stronger in line with the tone of the oral instructions that it received. Wong, J. Tr. 2176:6-13; Yan Tr. 2029:23-2030:7. There obviously was no "conspiracy"—KPMG Huazhen acted on its own and with the involvement of reputable U.S. counsel, Yan Tr. 2019:3-12, Wong, J. Tr. 2279:21-24, and the CSRC rejected KPMG Huazhen's proposed revision, Yan Tr. 2017:19-25.

IV. THE SECTION 106 REQUESTS ARE UNENFORCEABLE, PARTICULARLY BECAUSE THE CSRC IS AN ALTERNATIVE MEANS FOR OBTAINING THE REQUESTED DOCUMENTS

A. Because an Alternative Means of Obtaining the Documents Exists, the Section 106 Requests Are Unenforceable.

As set forth in DTTC's pre-hearing brief, there can be no basis for finding that Respondents "willfully refused" under Section 106 if the SEC's document demands are unenforceable in the first instance, such that Respondents would not be required to comply with them. That is the case even where, as here, the Division has apparently disavowed any attempt to enforce document demands or otherwise obtain the documents from Respondents in this proceeding.[50]

As previously discussed, *see supra* Section III.A, the record leaves no doubt that the Section 106 requests would require Respondents (China-based audit firms) to violate Chinese law on Chinese soil, defy the direct orders of several Chinese governmental entities, and subject themselves and their personnel to potentially severe sanctions, including dissolution, revocation of their licenses, and imprisonment. The enforceability of document demands in such circumstances depends on a number of factors derived from the Restatement of Law of Foreign Relations and principles of international comity. *See, e.g.*, *United States v. First Nat'l Bank of Chi.*, 699 F.2d 341, 345 (7th Cir. 1983); Restatement (Third) of Foreign Relations Law of the U.S. § 442 (1987) (providing that a "court *or agency of the United States*" must address these considerations of international comity in determining the enforceability of document demands)

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[50] *See, e.g.*, Josephs Tr. 81:3-6; Rana Tr. 224:1-4; Peavler Tr. 289:24-290:2; SEC's Memorandum of Points and Authorities Opposing Motion to Extend Stay ("SEC's Opp. to Mot. to Extend Stay"), at 6, *SEC v. Deloitte Touche Tohmatsu CPA Ltd.*, No. 11 Misc. 512 (D.D.C. Jan. 24, 2013); *see id.* at 7 ("No production of documents is sought in [the previous DTTC 102(e)] proceeding."); *id.* at 18 ("[T]he Division does not seek to compel the production of documents in [this] proceeding.").

(emphasis added)).[51] Here, these factors must be applied consistent with the D.C. Circuit's strong reluctance to order violations of foreign law on foreign soil. *In re Sealed Case*, 825 F.2d at 498 ("[I]t causes . . . considerable discomfort to think that a court of law should order a violation of law, particularly on the territory of the sovereign whose law is in question."). The hearing has made clear that the balance of factors weighs decisively against enforcement of the instant Section 106 requests, and, for this reason as well,the Division cannot prove a "willful refusal."

B. The Evidence Demonstrates That the CSRC is an Alternative Means for Obtaining the Requested Documents.

Recent events have decisively undermined the Division's position that the CSRC is not a "viable gateway" for obtaining audit workpapers. Specifically, as the evidence established at the hearing, the CSRC has developed new procedures—as mandated by Chinese law—for producing workpapers to U.S. regulators, which have the approval of the State Council. *See* Respondents Ex. 455 (Letter from D. Tong to E. Tafara (June 28, 2011)) (advising the SEC that, under Chinese law, "the CSRC is authorized to provide the [requested] documents to the SEC" only after completing certain "screening" procedures, and noting the CSRC's progress in "undertaking the required internal procedures"); George Tr. 1635:11-1636:5 (explaining the CSRC's newly-implemented process for "preparing working papers for production to a foreign regulator"); *see also* Respondents Ex. 631A, at 1 (*The first time that the CSRC provides working papers of a relevant company to foreign regulators*, China Securities Journal (July 9, 2013)) ("The CSRC official indicated that foreign regulators can make a request to the CSRC through

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[51] *See also In re Westinghouse Elec. Corp. Uranium Contracts Litig.*, 563 F.2d at 997; *Minpeco, S.A. v. ContiCommodity Servs., Inc.*, 116 F.R.D. 517, 522 (S.D.N.Y. 1987); Restatement (Second) of Foreign Relations Law of the U.S. § 40 (1965); *cf. Societe Nationale Industrielle Aerospatiale v. U.S. Dist. Court*, 482 U.S. 522, 544 n.28 (1987) (recognizing a draft of what is now § 442 of the Restatement (Third) of Foreign Relations Law of the United States as "relevant to any comity analysis").

cooperation channel and after the CSRC has produced the audit working papers, there is no reason for the U.S. to sue related Chinese accounting firms."); Leung Tr. 1476:18-1477:3; Chiu Tr. 1786:23-1787:5. This new protocol provides the Division with an effective and diplomatic means of obtaining the documents here at issue. Well-settled authority therefore precludes enforcement of the Section 106 requests.

Importantly, the CSRC has already demonstrated the efficacy of its production process. After applying its newly-devised procedures, the CSRC made a voluminous production of Longtop audit workpapers to the SEC in July. Respondents Ex. 637; *see also* George Tr. 1636:6-23 (confirming that "the Longtop working papers have now been produced by the CSRC to the SEC"). Thereafter, the SEC stayed its hand in the *Longtop* action pending review of the documents. *See* Respondents Ex. 633 (Notice to the Court, *U.S. Securities and Exchange Commission v. Deloitte Touche Tohmatsu CPA Ltd.*, 11 Misc. 512 GK/DAR (D.D.C. June 10, 2013)). In so doing, the Commission acknowledged the clear importance of an alternate means in considering the enforceability of (or the need to enforce at all) a document request.

The CSRC is currently working to facilitate delivery of the documents underlying this proceeding. In fact, several witnesses confirmed that the CSRC has already begun the process of preparing for production the DTTC Client A, Client G, and Client C workpapers. George Tr. 1636:24-1637:23 (discussing DTTC Client A and Client G); Leung Tr. 1480:20-25 (Client C). Indeed, the screening procedures are now complete for the DTTC Client A and Client G workpapers, and those workpapers were delivered to the CSRC in mid-May and early July, respectively. George Tr. 1637:2-1638:23. DTTC's expectation is that those workpapers will be delivered to the SEC. *Id.* Similarly, pursuant to the PCAOB-CSRC-MOF MOU, EYHM has produced the Client C documents to the CSRC as noted above, and KPMG was requested to

produce documents to the CSRC relating to Clients D and F. Respondents Exs. 632, 649A, 650A; Yan Tr. 1926:3-1927:13.

The Division itself has (at least) twice previously acknowledged—appropriately so—that this proceeding would be rendered unnecessary if the CSRC became a viable gateway for producing audit workpapers, and that has now happened. [redacted] Yet, the Division and OIA Assistant Director Alberto Arevalo persist in their erroneous view that the CSRC is not a viable gateway. Remarkably, Mr. Arevalo testified to that effect just three days before 20 boxes of hard-copy audit workpapers and a disc of electronic files arrived at that the SEC. Arevalo Tr. 1066:17-1067:11.

The Division's view as to the viability of the CSRC as a means of obtaining the documents is no longer credible and simply cannot be accepted. And, it tellingly contradicts the view recently expressed by U.S. Treasury Secretary Jacob Lew, who just last month hosted the U.S.-China Strategic Economic Dialogue in Washington, D.C. (attended by SEC Chairman White) and described the Longtop production as "an important step towards resolving a long-standing impasse on enforcement cooperation related to companies that are listed in the United

States." Respondents Ex. 634 (Remarks of Treasury Secretary Jacob J. Lew at the Close of the Fifth U.S.-China Strategic and Economic Dialogue (July 11, 2013), *available at* http://www.treasury.gov/press-center/press-releases/Pages/jl2008.aspx).

Recent events aside, the passage of time preceding the CSRC's first production of documents fails to establish that the CSRC is not a viable gateway to obtain documents from China. Before the SEC's request for the DTTC Client A workpapers, the CSRC had never before attempted to produce audit workpapers to a foreign regulator, and the unprecedented process predictably took time. *See* Respondents Ex. 469 (E-mail from D. Tong to E. Tafara and K. Brockmeyer (Mar. 30, 2012)) (explaining the CSRC's "enormous work to try to go through the necessary internal and external procedures" to accommodate the SEC's request, and indicating that "this is the first time that a Chinese regulator is trying to provide to a foreign regulator Chinese audit working papers"). The evidence suggests that the SEC consistently told the CSRC that bank records—*not* audit workpapers—were its priority, and the CSRC appeared to focus its efforts accordingly. *See* Respondents Ex. 457 (Letter from E. Tafara to D. Tong (July 5, 2011)) (explaining that the SEC's outstanding "MMOU requests for bank records are our first priority"). The evidence also indicates that the CSRC did, in fact, produce some documents to the SEC (albeit not audit workpapers), which the Division's key witness on this issue still characterized as not constituting "meaningful assistance" even though he and the Division claimed to know nothing about the circumstances of those productions. Arevalo Tr. 1219:22-1220:9; ENF Ex. 236 (E-mails and attachment from E. Tafara to D. Tong (Oct. 26, 2012)) (confirming the SEC's receipt of documents from the CSRC in November 2010 in response to a January 2010 request for assistance).

The evidence further demonstrated that in 2012 the CSRC offered to produce workpapers to the SEC on certain interim conditions, which the SEC rejected.[52] *See* Respondents Ex. 476 (E-mail from D. Tong to E. Tafara (Apr. 11, 2012)) (confirming that the CSRC had "obtained necessary approval" and was "now ready to deliver to [the SEC] the portion of the audit working papers for the year 2008 and 2009 regarding the company of [DTTC Client A]," subject to certain conditions); Arevalo Tr. 1186: 15-1189:16; Respondents Ex. 183 (Declaration of A. Arevalo, filed in *SEC v. Deloitte Touche Tohmatsu CPA Ltd.*, No. 11 Misc. 512 (D.D.C.) (Dec. 3, 2012)) ("The SEC staff was and is unwilling to accept the pre-conditions to the CSRC's production of the requested documents, or the CSRC's production of only a limited portion of the requested materials based on the CSRC's own relevance determinations."). Apparently, another foreign regulator accepted such interim conditions and thereby obtained documents promptly. *See* Respondents Ex. 484 (E-mail from D. Tong to E. Tafara (July 19, 2012)) (informing the SEC that another foreign regulator "just signed our proposed Letter of Consent regarding one enforcement request and we will [be] providing them the information quickly"); Arevalo Tr. 1191:4-1192:4. The Division contended that the proposed terms were "unacceptable," Arevalo Tr. 1010:9-20, but the fact remains that, over a year ago, it had the opportunity to review the DTTC Client A workpapers, determine if they were important to its ongoing investigation, use that information—if not the actual documents—in the investigation, and, if necessary, negotiate with the CSRC regarding further use of the documents.

[52] Indeed, the CSRC even offered to have the SEC review the workpapers in China, but the Division never pursued this opportunity. *See* Respondents Ex. 467 (E-mail from D. Tong to E. Tafara (Jan. 30, 2012)) (inviting "someone for the SEC enforcement side to come to CSRC to take a look at the [DTTC Client A] working papers" upon completion of the CSRC's "state secrecy and confidential screenings" and "take only those documents that are useful to you"); Arevalo Tr. 1166:17-1170:5 (confirming that the SEC made no meaningful effort to realize the possibility of an on-site inspection in China).

Ultimately, the SEC took an all-or-nothing position with the CSRC—a "my way or the highway" approach that the Commission's current Chairman very recently rejected as a basis for "reconciling the U.S. regulatory system with requirements in other jurisdictions." *See* Mary Jo White, Speech on Regulation in a Global Financial System (May 1, 2013), *available at* http://www.sec.gov/news/speech/2013/spch050313mjw.htm ("A defining fact of life at the SEC today is that we are not alone in the global regulatory space. And our duty to the investors, entrepreneurs, and other market participants who rely on us means that we must find common ground with our counterparts abroad, collaborate on everyday matters like enforcement and accounting, and knit together a regulatory network that offers protection, consistency, and stability to market participants—especially in the United States but abroad as well."). But rather than accept interim measures or negotiate a new MOU, the Division pressed its questionable view that the IOSCO MMOU covered audit workpapers and demanded that the CSRC produce huge volumes of documents in short periods of time that were tied specifically to its litigation strategy.[53] *See, e.g.*, ENF Ex. 230 (Letter from E. Tafara to D. Tong (Aug. 6, 2012)).[54] That the

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[53] The Division's litigation position that the IOSCO MMOU unambiguously covers audit workpapers is belied by the fact that OIA Director Ethiopis Tafara apparently thought otherwise. *See* Arevalo Tr. 1089:3-1090:24 (confirming that "the two top officials of OIA" held different understandings as to the applicability of the IOSCO MMOU); ENF Ex. 325, ¶ 26 (Declaration of E. Tafara, filed in *SEC v. Deloitte Touche Tohmatsu CPA Ltd.*, No. 11 Misc. 512 (D.D.C.) (Dec. 3, 2012)). In addition, the SEC recently entered into an enhanced enforcement MOU with the Australia securities regulator that explicitly covers audit workpapers. Memorandum of Understanding Concerning Consultation, Cooperation, and the Exchange of Information Related to the Enforcement of Securities Laws, Annex A (Aug. 25, 2008), *available at* http://www.sec.gov/about/offices/oia/oia_mututal_recognition/australia/enhanced_enforcement_mou.pdf (identifying "accounting information (including audit work papers)" as a "categor[y] within scope of assistance"). The Australian regulator is also a signatory to the IOSCO MMOU, and if that MMOU already clearly covered audit workpapers, such a supplemental MOU would be wholly unnecessary. Ultimately, the only reason the DTTC Client A workpapers arguably fell under the IOSCO MMOU was that the CSRC went out and obtained them from DTTC. *See* ENF Ex. 207, at 2-3 (Letter from E. Tafara to D. Tong (May 27, 2011)) (asserting the SEC's position that the DTTC Client A workpapers were covered by the IOSCO MMOU because they were "held" in the CSRC's "files" after the CSRC obtained the documents from DTTC upon receipt of the SEC's June 7, 2010 request for assistance).

CSRC did not produce the documents exactly as requested by the SEC in this context does not mean it was not a viable alternative means. This conclusion is underscored by the PCAOB's success in negotiating an MOU with the CSRC and MOF during this exact same time period.

In any event, the documents are *now* flowing from the CSRC and therefore viable alternate means currently exist for obtaining the documents. This is exactly the reason why Congress included Section 106(f), and it is unreasonable not to use 106(f) under these circumstances.[55] Equally important, where there are multiple Respondents, it is entirely unfair to sanction a firm for failure to produce documents under Section 106 as a result of local law impediments when the Division has never itself even requested that the CSRC assist it in obtaining the materials. Even as of today, to the best of Respondents' knowledge, for example, neither the Division nor any other part of the SEC has ever made a request to the CSRC or any governmental authority in China for assistance in obtaining the in-progress workpapers of PwC

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[54] "If the SEC and CSRC are not able to reach an agreement pursuant to which the SEC staff receives the materials by October 1, 2012, the SEC will have no choice but to explain to the Court that efforts to obtain the materials through the CSRC were not successful. This will be necessary because, among other things, Deloitte Shanghai has argued before the Court against sanctions for failure to obey the SEC's subpoena because the SEC can get the requested materials through the CSRC. To refute this argument..., the SEC will be required to detail in the public court record the unsuccessful history of requests to the CSRC..." *Id.*

[55] Under Section 106(f), the Staff "may allow a foreign public accounting firm ... to meet production obligations under this section through alternate means, such as through foreign counterparts of the Commission or the Board." 15 U.S.C. § 7216(f). At minimum, once the Staff invokes Section 106(f) and "allow[s]" a firm to meet its obligations in this manner, it cannot subsequently reverse course and punish the firm merely because those alternate means were not to the Staff's satisfaction. Here, the Division chose to "allow" DTTC to "meet production obligations" through an "alternate means": it requested the DTTC Client A and Client G workpapers through the CSRC. And although it took more time than the Staff would have liked, that process is now working. In any event, having invoked Section 106(f) in these two instances, the Staff cannot now punish DTTC for not producing the requested documents directly to the SEC. And it then becomes an absurdity to sanction the other firms because the Division deliberately chose not to seek their workpapers from the CSRC under Section 106(f). Indeed, as discussed below, the SEC and PCAOB have only requested documents from the CSRC related to half of the issuers. Assuming the success of obtaining documents through that avenue, it cannot be correct that some Respondents would be sanctioned while others are not simply based on the decision of U.S. regulators as to which workpapers to request. The sanctions sought by the Division simply cannot turn on an arbitrary decision that it makes. For this independent reason, the Division cannot establish a "willful refusal" here.

Shanghai related to Clients H and I.[56] This is true despite the fact that PwC Shanghai repeatedly urged the Division to do so and made clear in its words and deeds that it wanted to facilitate the production of the documents requested of it by the Division.

C. The Other Comity Factors Weigh Heavily Against Enforcement of the Section 106 Requests.

Although the availability of an alternative means of accessing the requested documents is alone sufficient to render the requests unenforceable, the other relevant factors strongly support non-enforcement as well. These factors include: "(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 another state; (d) the nationality of the person; [and] (e) the importance to the litigation of the information and documents requested." DTTC's Pre-Hearing Brief at 37. Each of the points articulated in DTTC's pre-hearing brief still ring true, *id.* at 40-42, and the evidence presented at the hearing only further bolsters them.

Hardship of Compliance. As explained in Section III.A.3, the evidence is clear that Respondents would face severe punishment for producing the requested documents directly to the SEC without authorization from the CSRC. Both sides' Chinese law experts agree that the Chinese authorities could dissolve Respondents or revoke their licenses for violating the relevant Chinese laws, and that the production of state secrets information (which has been identified in every set of workpapers produced to the CSRC to date) could result in criminal punishment.[57]

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[56] The same appears to be true for workpapers related to KPMG's Clients D, E, and F, EYHM's Client B, and Dahua's Client A.

[57] Clarke Tr. 2397:21-25; Clarke Expert Report ¶ 23; Tang Expert Report ¶¶ 15, 51, 54, 57; Feinerman Rebuttal Report ¶ 6. As discussed, Professor Tang also opined—without dispute—that the unauthorized production of workpapers here could expose Respondents to criminal penalties under the Archives Law. Tang Tr. 2423:24-2427:22.

The Division made no real attempt to rebut the severe hardship that would accompany compliance with the requests, as Professor Clarke explicitly noted that he provided no opinion on the likelihood of sanctions in this case. Clarke Tr. 2406:9-14; *see also* Clarke Tr. 2404:13-2405:2. Under well-settled law, imposing such hardship on Respondents is particularly inappropriate where, as the evidence made clear, they are not the target of the underlying investigations and have provided substantial and important assistance. *See Tiffany (NJ) LLC v. Qi*, 276 F.R.D. 143, 158 (S.D.N.Y. 2011). Accordingly, the severe penalties that Respondents would face for violating Chinese law here severely undermine the enforceability of the requests.

Importance of the Documents to the Investigation. While audit workpapers can be important to SEC investigations, the record here reflects contradictory actions and a curious failure by the Division to pursue all available means for obtaining the documents at issue. As an initial matter, the Division has forgone its statutory right to seek enforcement of the Section 106 requests in federal court and expressly disavowed any attempt to obtain the documents in this proceeding.[58] In fact, despite the CSRC's recent production of SEC requested workpapers, the Division and the PCAOB combined have requested workpapers under the CSRC's new procedure for only half of the issuers involved in this proceeding.[59] Further, when the SEC did request the documents through the CSRC, it explicitly stated that bank records, not workpapers, were its first priority. Arevalo Tr. 1152:4-18, 1154:8-21; ENF Ex. 212, at 3 (Letter from E. Tafara to D. Tong (July 5, 2011)) ("The MMOU requests for bank records are our first

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[58] *See supra* note 50.

[59] Respondents Ex. 632A (CSRC request for Client C documents on behalf of the PCAOB); Leung Tr. 1477:19-1480:25 (Client C workpapers have been reviewed and delivered to the CSRC); George Tr. 1636:24-1637:23 (DTTC Clients A and G workpapers have gone through the new process and been produced to the CSRC); Respondents Ex. 650A (CSRC request for Clients D and F documents on behalf of the PCAOB); Yan Tr. 1927:1-13 (confirming that a team of people has started the review of the materials to be submitted to the CSRC).

priority."). And when the CSRC responded, the Division rejected an interim approach proposed by the CSRC that would have allowed it to review the requested documents (and use any information obtained in furtherance of its investigation), and did not pursue an offer to allow full access to the documents in China. Arevalo Tr. 1168:8-23, 1187:11-1189:16, 1202:8-13; ENF Ex. 255.

Remarkably, the Division's witnesses, including the Chief of International Cooperation and Technical Assistance from the SEC's Office of International Affairs, repeatedly testified that they had not even read the PCAOB-CSRC-MOF MOU for the purposes of obtaining the documents, despite the fact that it explicitly gives the PCAOB access to workpapers and allows those documents to be shared with the SEC. Respondents Ex. 274, Arts. III, IV, VII, XII, and IX; Josephs Tr. 89:6-91:4; Weinstein Tr. 683:4-23; London Tr. 922:17-923:1; Arevalo Tr. 1106:23-1107:19 (explaining that he "read [the MOU] very quickly").[60] If the documents were truly vital to fulfilling the Division's mandate, then presumably someone (including especially Mr. Arevalo) would have read an international agreement that unequivocally allowed access to those very documents.

Ultimately, the Division's witnesses could not explain with any precision why these workpapers would be particularly important to its investigations. In most cases, Respondents did not even issue audit opinions and performed only cursory work before resigning or being fired, so any claim to assess audit quality rings hollow. And even without the requested audit workpapers, the Division still has been able to successfully bring charges against the issuers and individuals responsible for the fraud. *See, e.g.*, ENF Ex. 57 (civil complaint filed against Client C, its chairman, and former CEO and CFO); Peavler Tr. 283:7-13 (discussing same);

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[60] One SEC witness was not even aware of the PCAOB-CSRC-MOF MOU. Kaiser Tr. 452:19-453:14.

Respondents Ex. 36 (Order Instituting Proceedings against Client B); London Tr. 854:2-9 (confirming that federal charges were filed against Client H); ENF Ex. 75 (complaint filed against Client E and its former CFO); Rana Tr. 199:19-200:6 (discussing same). Against this backdrop, the audit workpapers cannot be deemed so important as to justify ordering Respondents to violate Chinese law.[61]

Balance of Sovereign Interests. Another factor relevant to the enforceability of the Section 106 requests is the respective "interests of each nation in requiring or prohibiting disclosure" and "whether disclosure would affect important substantive policies or interests of either" the United States or China. *Richmark Corp. v. Timber Falling Consultants*, 959 F.2d 1468, 1476 (9th Cir. 1992) (citation omitted). During the course of the hearing, it became crystal clear that the Division's interest in this circumstance is now quite limited. With the production of the Longtop workpapers and forthcoming productions of other documents, *see, e.g.*, George Tr. 1636:6-1637:23; Chiu Tr. 1791:5-1793:8, Leung Tr. 1480:20-25, the only interest presently at stake here is the SEC's interest in getting documents directly from Respondents, rather than through the Chinese regulators. In either scenario, the Division obtains the documents. Therefore, any Division interest is exceedingly limited. Conversely, China maintains a legitimate interest in managing document requests from foreign regulators—an interest the Division has itself acknowledged as legitimate. *See* SEC's Reply Memorandum in Support of Its Application for Order Requiring Compliance with Subpoena at 3, *U.S. Securities and Exchange Commission v. Deloitte Touche Tohmatsu CPA Ltd.*, 11 Misc. 512 GK/DAR (D.D.C. Dec. 3,

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[61] Indeed, in apparent recognition that this assured burden on Respondents would undermine the enforceability of the document demands, the SEC's own witness conceded that the restrictions on production under Chinese law (of which she was admittedly unaware) would have been "important" to her decision whether to issue a Section 106 request to DTTC in the first instance. Chang Tr. 731:3-19.

2012).[62] The SEC's historical actions also acknowledge the legitimacy of that interest, including with such key Western allies as the United Kingdom and Germany and as demonstrated by its numerous agreements with other sovereigns that have decided to control document requests from foreign regulators. Feinerman Tr. 2520:12-2521:15; Atkins Tr. 2654:2-2660:21; Feinerman Expert Report ¶¶ 30-34.; Atkins Expert Report ¶¶ 20-28. Pursuant to such arrangements, it is not unusual for a foreign regulator to require that any productions to U.S. regulators be made through the foreign regulator, so that the foreign regulator has the opportunity to ensure that its local laws are respected. Feinerman Expert Report ¶ 30; Feinerman Tr. 2520:12-2521:15; Atkins Tr. 2658:9-2659:6. The Division's interest in exercising appropriate oversight can now be achieved through a regulator-to-regulator arrangement. It is clear that workpapers are going through the Chinese-government approved process, which has already resulted in their production of workpapers. The SEC's residual interests here do not justify this intrusion on Chinese sovereignty and subjecting Respondents to harsh punishment in China.

Location of Information and Parties. When the relevant party is not a U.S. citizen and the information at issue originated outside of the United States, courts are disinclined to order compliance with an information request. *Richmark*, 959 F.2d at 1475; *see also In re Sealed Case*, 825 F.2d at 498 (acknowledging significant reservations about requiring a foreign entity to violate another country's laws in the territory of that sovereign). To the extent there were ever any doubt, the evidence indisputably confirmed that the Respondent audit firms, including all their personnel and operations, and the requested documents reside entirely within mainland China. *See, e.g.*, Chao Tr. 1285:9-16; Leung Tr. 1401:6-25, 1407:24-1408:5; Wong, J.

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62 "For example, DTTC notes that Germany and the United Kingdom take analogous positions to that of the CSRC with regard to direct production of certain documents abroad. (DTTC Mem. 31). And we agree that, in that case, Germany's and the United Kingdom's sovereign interests are valid and, generally speaking, should be respected."

Tr. 2146:7-15, 2148:18-24, 2150:14-20, 2203:5-10, 2203:25-2204:6; George Tr. 1597:16-19; Yan Tr. 2001:11-12. Because enforcement of the request would operate entirely outside of the United States, this factor decidedly weighs against enforcement.

On such a record, the underlying Section 106 requests are unenforceable under principles of international comity; and, therefore, Respondents cannot have "willfully refused" to comply with them.

V. AT MINIMUM, THE EVIDENCE DEMONSTRATES THAT RESPONDENTS' LEGAL OBLIGATIONS WERE OBJECTIVELY UNCLEAR

As explained in DTTC's pre-hearing brief, a party does not "willfully" violate a statute if its conduct was based on an "objectively reasonable" understanding of its legal obligations—even if that understanding is later determined to have been erroneous. *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47, 69-70 & n.20 (2007). In several respects, the evidence presented at the hearing demonstrated precisely how uncertain their legal obligations were at the time Respondents were unable to comply with the Section 106 requests, and showed that Respondents' interpretation of their enforceable duties under U.S. and Chinese laws was entirely reasonable. Thus, irrespective of whether the Section 106 requests are *now* deemed valid and enforceable, Respondents cannot—as a matter of law—be found to have "*willfully* refused" or "*willfully* violated" Section 106 prior to this case of first impression.[63]

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[63] After issuance of the OIP, this Court ruled that a Section 106 request need not be enforced in federal court before a disciplinary proceeding for non-compliance is initiated. *See* Order on Motions for Summary Disposition as to Certain Threshold Issues, at 7, File Nos. 3-14872, 3-15116 (Apr. 30, 2013) ("The Division was not required to obtain a ruling from a federal court regarding the enforceability of the Section 106 requests before instituting these proceedings."). Nonetheless, it was certainly *reasonable* for Respondents to conclude otherwise at the time of their purported "willful refusal." In fact, each of the Section 106 requests underlying this proceeding was accompanied by the SEC's Form 1662, which stated:

> If you fail to comply with the subpoena, the Commission may seek a *court order* requiring you to do so. *If such an order is obtained and you thereafter fail to supply the information*, you may be subject to civil and/or criminal sanctions for contempt of court.

First, as discussed in Respondents' Motion for Summary Disposition as to Certain Threshold Issues,[64] the SEC never sought to enforce the Section 106 requests in court before initiating this proceeding. That alone is sufficient to render Respondents' legal obligations sufficiently uncertain that a finding of "willful" conduct is not permitted under *Safeco*. But a fully developed record has shown that, under the applicable multi-factor balancing standard, the underlying enforceability of the Section 106 requests is particularly subject to doubt. Further underscoring this ambiguity is evidence that the Commission has consistently *refrained* from forcing foreign firms to violate the laws of their home states. Indeed, although audit firms in over fifty countries have identified legal impediments similar to those confronting Respondents, the SEC has not initiated a *single* sanctions action against any such firm. Rather, the Commission in these instances has uniformly pursued sovereign-to-sovereign solutions with its foreign counterparts. *See* Atkins Tr. 2654:7-21 (recounting the SEC's consistent policy, as articulated by then-Commissioner Schapiro, of pursuing "collaboration and cooperation" instead of "creat[ing] an international diplomatic incident" in obtaining foreign documents); *see also id.* at 2658:14-2659:6 (discussing the SEC's efforts in the European Union and UK to overcome "strict privacy laws" via regulator-to-regulator agreements).[65] It was therefore eminently

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Against that backdrop, it was entirely foreseeable that Respondents would understand judicial enforcement as a necessary procedural step in clarifying their legal obligations. By the same token, even if this Court is authorized to determine the enforceability of the Section 106 requests (which Respondents dispute), such a decision would have no bearing on the clarity, or lack of it, regarding Respondents' legal duties when they first received the document demands.

[64] *See also supra* p. 62.

[65] For example, the SEC was able to overcome "strict privacy laws" by using the precise regulator-to-regulator method of requesting workpapers from UK and EU firms that was proposed by Respondents' counsel in 2004, Respondents Ex. 202 (Letter from Linklaters to the PCAOB Re: Proposed Auditing Standard on Audit Documentation and Proposed Amendment to Interim Auditing Standards (Jan. 20, 2004)), and which is now reflected in the UK regulator's website, which provides instructions directing all foreign regulators requesting assistance of production from UK audit firms to address those requests to

reasonable for Respondents to expect such a result here, including a cooperative arrangement that would allow them to satisfy the competing directives of the Commission and the CSRC.

Those expectations, moreover, are evidenced by the very substantial investments Respondents made in building their firms from 2004 to the present—in terms of personnel, offices and expertise. *See* Chao Tr. 1315:25-1319:25; Leung Tr. 1482:11-1488:24; Ji Tr. 2050:24-2052:17; Wong, J. Tr. 2142:8-13. Those efforts and investments, including in U.S. GAAP and PCAOB auditing standards expertise, demonstrate that Respondents did not expect that they would ever face sanctions barring them from practicing before the Commission due to the conflict of laws they raised in 2004. Otherwise, it would simply have been irrational to make the substantial investments in the development of Chinese firms that are now in jeopardy.

Finally, in addition to the enforceability of the Commission's document demands, the evidence forecloses any suggestion that the language of Section 106 itself clearly carried the narrow meaning that the Division now advocates. Respondents maintain that "willful refusal" requires evidence of bad faith in this circumstance. For the reasons explained herein and in DTTC's pre-hearing brief, Respondents contend that Congress purposely used that statutory formulation to impose a heightened standard of liability by requiring proof of bad intent and bad faith, and not merely a failure to act. But even if this Court ultimately adopts the Division's proffered construction, such a construction was certainly not the *only* plausible interpretation available before this case of first impression. (And Respondents maintain that it is not a plausible construction in any event.) Respondents' actions prior to this proceeding were based on an objectively reasonable understanding of the strictures of Section 106, and sanctions are therefore unavailable. *See Safeco*, 551 U.S. at 70 (holding that where a "dearth of guidance and .

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the Financial Conduct Authority. Respondents Ex. 585. That procedure allows the UK regulator to facilitate production without placing UK firms in violation of data privacy laws.

. . less-than-pellucid statutory text" render a party's "reading" of a statute "not objectively unreasonable," the party's violation of the statute cannot be deemed willful).[66]

To paraphrase the Supreme Court's ruling in *Safeco*, "it would defy history and current thinking to treat" Respondents as "[willful] violator[s]" merely for acting in accordance with their reading of Section 106. *Safeco*, 551 U.S. at 70 n.20. The evidence is clear that Respondents did not "willfully refuse" to produce documents. But even if that standard were somehow otherwise met, there is no question that Respondents acted in compliance with their understanding of the burdens imposed by Section 106. Under *Safeco*, such uncertainty precludes a finding of "willfulness" as a matter of law.

VI. IMPOSING SANCTIONS WOULD BE INAPPROPRIATE AND WOULD HARM THE PUBLIC INTEREST

As demonstrated above, the Division has failed to prove that Respondents willfully refused to comply with the Section 106 requests, and has therefore failed to establish any violation of law for which Respondents could be sanctioned. But in any event, the sanctions it seeks in this case are inappropriate and would be manifestly contrary to the public interest. As shown above, the institution of these disciplinary proceedings was unprecedented, and the sanctions the Division seeks are also entirely unprecedented. The Division has proposed that Respondents be: (1) censured, (2) permanently barred from issuing audit reports for issuers with securities traded in the United States, and (3) permanently barred from playing a 50 percent or greater role in the audits of such issuers (the "Proposed Bar"). *See* ENF Pre-Hearing Brief at 58, 65. The Division's proposal does not—as it would in ordinary disciplinary proceedings—seek to

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[66] Critically, the dispositive question is whether Respondents' legal obligations at the time they are alleged to have "willfully refused" were so certain and unambiguous as to preclude more than one reasonable interpretation thereof. Any clarity that these proceedings have provided as to Respondents' enforceable obligations *at this juncture* has no bearing on that inquiry.

bar a single individual or firm from practicing before the Commission. Instead, it seeks in a single stroke to bar the bulk of the auditing profession of an entire country from auditing U.S. issuers.

The Division's proposed sanctions are unwarranted under the factors the Commission traditionally considers. As shown at the hearing, Respondents did not act egregiously or in bad faith. To the contrary, they found themselves caught between the conflicting demands of two sovereign states which—for reasons entirely outside of Respondents' control—have not yet been fully resolved. In these circumstances, any sanction of Respondents would violate basic rules of fundamental fairness. Moreover, the sanctions proposed by the Division would unnecessarily cause substantial harm to the firms, their issuer clients, and investors, while providing no discernible benefits to the Commission or the investing public.

The Division's proposed sanctions would have dramatically negative consequences for investors, issuers, and the U.S. securities markets. The evidence shows that the Division's proposal would cause as many as 118 issuers with over $464 billion worth of securities traded in the U.S. to lose their chosen auditors. As shown at the hearing, these issuers face a high likelihood of being unable to find qualified replacement auditors and of being delisted from the exchanges on which they currently trade. The estimated impact on investors from the delisting of these issuers ranged from less than $100 billion to more than $200 billion, but regardless, the economic impact is substantial and undeniable.

Finally, the Division's proposed sanctions would conflict with and undermine the Commission's decades-long policy of resolving foreign legal impediments through inter-governmental cooperation—a policy that, as of the date of this brief, is beginning to bear fruit

with respect to China. In short, the Division is unable to demonstrate that any sanctions should be imposed.

A. Sanctions May Not Be Imposed Unless They Are Warranted Under the Circumstances, Remedial in Nature, and Consistent With the Public Interest.

The Commission has made clear that "[n]ot every violation of law . . . may be sufficient to justify invocation of the sanctions available under" Rule 102(e)(1). *In the Matter of William R. Carter and Charles J. Johnson, Jr.*, Exchange Act Rel. No. 17597, 1981 WL 384414, at *6 (Feb. 28, 1981) (dismissing proceedings). The Commission must "do more than say, in effect, [Respondents] are bad and must be punished." *Blinder, Robinson & Co. v. SEC*, 837 F.2d 1099, 1113 (D.C. Cir. 1988). Instead, it must find that sanctions are "*necessary* to protect the investing public and the Commission from the future impact on its processes of professional misconduct." *Carter*, 1981 WL 384414, at *6 (emphasis added).

If the Division can demonstrate that a sanction is warranted under this standard, the Commission must then craft an appropriate sanction by considering a variety of factors. These factors traditionally include—but are not limited to—the "egregiousness of the [Respondent's] actions," the "isolated or recurrent nature of the infraction," and the "degree of scienter involved." *Steadman v. SEC*, 603 F.2d 1126, 1140 (5th Cir. 1979) (quoting *SEC v. Blatt*, 583 F.2d 1325, 1334 n.29 (5th Cir. 1978), *aff'd on other grounds*, 450 U.S. 91 (1981)). The inquiry is "a flexible one and no one factor is dispositive." *In the Matter of KPMG Peat Marwick LLP*, Exchange Act Rel. No. 43862, 2001 WL 47245, at *26 (Jan. 19, 2001). The greater the sanction imposed, the greater the Commission's burden to show that the sanction is justified *and* that lesser sanctions would be insufficient to serve the public interest. *See PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007); *Steadman*, 603 F.2d at 1139; *see also In the Matter of*

Harrison Secs., Inc., Frederick C. Blumer and Nerissa Song, S.E.C. Rel. No. 256, 2004 WL 2109230, at *57 (Sept. 21, 2004).

The Commission's ability to impose sanctions is subject to three important limitations. First, the Commission must exercise "reasoned decisionmaking." *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 374-75 (1998). As the *Steadman* court itself noted, mechanically applying the *Steadman* factors is simply insufficient. *See Steadman*, 603 F.2d at 1140. Instead, the Commission must give reasoned consideration to all important aspects of the problem that the sanctions are meant to address. *See, e.g.*, *Saad v. SEC*, No. 10-1195, 2013 WL 2476807, at *5 (D.C. Cir. June 11, 2013). It must, for example, consider and give appropriate weight to relevant mitigating factors raised by a respondent. *See, e.g.*, *PAZ*, 494 F.3d at 1065. Among the mitigating factors that must be considered is the collateral impact sanctions would have on Respondents and on third parties, including investors. *See id.*; *Saad*, 2013 WL 2476807, at *5. Furthermore, any sanctions must be proportionate to the conduct at issue. *See, e.g.*, *Chambers v. NASCO, Inc.*, 501 U.S. 32, 40 n.5 (1991). As discussed below, the Division has plainly failed to meet these requirements.

Second, any sanction imposed under Rule 102(e) must be remedial in nature, not punitive. *See McCurdy v. SEC*, 396 F.3d 1258, 1264 (D.C. Cir. 2005) ("The Commission may impose sanctions for a remedial purpose, but not for punishment."). The purpose of Rule 102(e) is "to determine whether a person's professional qualifications . . . are such that he is fit to appear and practice before the Commission." *Touche Ross & Co. v. SEC*, 609 F.2d 570, 579 (2d Cir. 1979). "The Commission has made it clear that its intent in promulgating Rule 2(e)[67] was not to utilize the rule as an additional weapon in its enforcement arsenal, but rather to determine

[67] Rule 2(e) was recodified as Rule 102(e) in 1995. *See* Implementation of Standards of Professional Conduct for Attorneys, 67 Fed. Reg. 71,670, 71,671 n.11 (Dec. 2, 2002).

whether a person's professional qualifications, including his character and integrity, are such that he is fit to appear and practice before the Commission." *Id.* In order for a sanction to be considered remedial, it must focus principally on—and be rationally related to—preventing future misconduct. *See SEC v. Patel*, 61 F.3d 137, 141-42 (2d Cir. 1995). Sanctions that are not rationally related to preventing future misconduct are punitive and are not permitted under Rule 102(e). Again, the Division has failed to meet this test.

Third, the Commission's sanctions may not arbitrarily and capriciously conflict with long-standing policies and practices. Under the Administrative Procedure Act, when an agency changes policies, it "must display awareness that it *is* changing position" and it "must show that there are good reasons for the new policy." *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009). Those burdens are especially heavy when the Commission's prior policy has "engendered serious reliance interests," as it has done here. *Id.* Put differently, "[a]n agency's failure to come to grips with conflicting precedent constitutes 'an inexcusable departure from the essential requirement of reasoned decision-making.'" *Ramaprakash v. FAA*, 346 F.3d 1121, 1125 (D.C. Cir. 2003) (quoting *Columbia Broad. Sys. v. FCC*, 454 F.2d 1018, 1027 (D.C. Cir. 1971)). To the extent that the Division's proposed sanctions conflict with past Commission practices, the Commission must provide a "reasoned analysis" demonstrating that past practices are not being "casually ignored." *Id.* at 1124 (citation omitted). The Division has not offered sufficient explanation for its abandonment of the Commission's traditionally preferred course of action, which is to pursue a cooperative agreement with foreign regulators in matters involving foreign legal impediments. This failure is particularly glaring given that, whatever challenges the SEC previously perceived, the CSRC is currently in the process of preparing productions of the requested workpapers.

B. Sanctions Would Be Inappropriate Under *Steadman* and *Carter*.

Applying the relevant factors, sanctions are not warranted in this case. As the Commission's decision in *Carter* made clear, the imposition of sanctions is not automatic. *See Carter*, 1981 WL 384414, at *6 ("[n]ot every violation of law . . . may be sufficient to justify invocation of the sanctions available under Rule 2(e)"). Instead, the Commission must decide whether a sanction is in the public interest and would be fair. The starting point—but by no means the ending point—of this inquiry is the multi-factor balancing test articulated in *Steadman*:

> [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.

603 F.2d at 1140 (quoting *Blatt*, 583 F.2d at 1334 n.29). The D.C. Circuit has rightly described the *Steadman* factors as setting a "daunting standard" for the Commission to meet. *Blinder*, 837 F.2d at 1111. And this "daunting standard" was not developed for the present context, where competing regulatory demands render the entire Chinese accounting profession unable to produce documents directly to the SEC. To the contrary, *Steadman*—like every other Rule 102(e) case of which Respondents are aware—involved a respondent whose actions were not compelled by the requirements of foreign law and the express instructions of a foreign government. Notwithstanding these distinctions, however, the *Steadman* factors weigh decisively in Respondents' favor.

1. Respondents' Actions Were Not Egregious.

As shown throughout the hearing and summarized in this brief, Respondents acted in good faith. Their conduct was not "egregious" — they were not "outstandingly bad" or "shocking." *Egregious*, Oxford Dictionaries, Oxford Univ. Press,

http://oxforddictionaries.com/definition/american_english/egregious (last visited Aug. 28, 2013). This is not a simple case where a party failed to produce requested documents out of obstinacy, bad faith, or even neglect. To the contrary, Respondents were unable to produce documents directly to the Division in response to its Section 106 demands only because doing so would have violated Chinese law and instructions from their Chinese regulators. *See supra* Section III.A. Indeed, the uncontradicted evidence shows that, after each of the Respondents received requests from the Division, Respondents met with both the CSRC and MOF and requested permission to produce documents directly to the SEC.[68] As detailed above in Section III.A.1, those meetings followed many other communications with Chinese regulators at which Respondents consistently sought authorization to produce documents to the Division, but the CSRC and MOF just as consistently denied that permission, reiterating that the SEC had to make any requests for workpapers located in China through the CSRC.[69] Respondents informed the Division of the CSRC and MOF's position and implored the SEC to seek the workpapers through cooperation with the CSRC.[70]

Respondents' actions thus lack any of the usual hallmarks of egregious behavior found in Rule 102(e)(1)(iii) actions. *See SEC v. Bankosky*, 2012 WL 1849000, at *2 (S.D.N.Y.

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68 *See* Leung Tr. 1459:3-1464:11; Wong, D. Tr. 1872:22-1878:2; Yan Tr. 1920:20-1923:7; Ji Tr. 2089:9-2090:8.

69 *Id.*

70 *See* ENF Ex. 35, at 3 ("Our hope is that the SEC can work with the CSRC pursuant to the memoranda of understanding between China and the United States."); ENF Ex. 47, at 7 ("To obtain the documents it is seeking, we urge the Commission to contact the PRC regulators directly."); ENF Ex. 56, at 13 ("We urge the SEC to help EYHM avoid this unfair dilemma and contact the PRC regulators directly."); ENF Ex. 67, at 2 ("[A]ny resolution of this matter requires the SEC to contact the [CSRC] and to seek to obtain the audit work papers and other documents through that agency of the PRC government."); ENF Ex. 94, at 4 ("We urge the Staff to reach out to the CSRC so that DTTC can lawfully make available the documents which the SEC seeks to review."); ENF Ex. 107, at 5 ("[W]e urge the Staff to agree that it should work with the CSRC directly to obtain materials and information related to [Client H].").

May 21, 2012) (collecting fraud cases to illustrate "[conduct] that courts usually rely on when finding securities law violations to be egregious").[71] Respondents defrauded no one;[72] did not act dishonestly; nor did they lack independence.[73] The Division's inability to obtain certain workpapers directly from the Respondents is due to Chinese legal impediments, rather than any substantive wrongdoing by Respondents. This factor favors Respondents.

2. Respondents' Actions Were Isolated.

None of the Respondents engaged in a pattern of misconduct in this matter. These proceedings are based on Respondents' inability to respond to a single Section 106 request with respect to each audit client. These requests were the first Section 106 requests received by each of the Respondents.[74] Indeed, eight of the ten Section 106 requests at issue here were sent within

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[71] The Division's attempt to establish a negligence standard for "egregiousness" is inaccurate and potentially misleading. In its pre-hearing brief the Division quoted a Commission opinion for the proposition that negligent behavior would be sufficiently egregious to support sanctions here. ENF Pre-Hearing Brief at 60 (quoting *In re Gregory M. Dearlove, CPA*, 92 SEC Docket 1427, 2008 WL 281105, at *30 (Jan. 31, 2008)). The Division's brief omitted that the case quoted was itself quoting a portion of a Commission release which was specifically discussing a different section of Rule 102(e) than the one under which the Division brought this case. *See id.* (quoting Amendment to Rule 102(e) of the Commission's Rules of Practice, 63 Fed. Reg. 57,164, 57,166 (Oct. 26, 1998)). The section of Rule 102(e) being discussed in the release enumerates two specific types of negligent conduct *specific to accountants* that are sufficient for Rule 102(e) liability, *see* Rule 102(e)(1)(iv)(B), and it was that section that the *Dearlove* court was analyzing in the Division's quoted excerpts. That the Division had an accountant-specific negligence standard available to it, but chose to bring this action under Rule 102(e)(1)(iii) instead is telling: Respondents' behavior in this case does not fit the mold of a harmful auditor that is unfit to practice before the Commission.

[72] *See e.g.*, *In the Matter of Robert W. Armstrong, III*, Exchange Act Rel. No. 51920, 2005 WL 1498425, at *8 (June 24, 2005); *In the Matter of Steven Altman, Esq.*, Exchange Act Rel. No. 63306, 2010 WL 5092725, at *19 (Nov. 10, 2010).

[73] *In re Horton & Co. and Edward C. Horton*, S.E.C. Rel. No. 208, 2002 WL 1430201, at *2 (July 2, 2002).

[74] For example, as a representative of KPMG Huazhen testified, "[t]his is the first time that Huazhen has received a Section 106 letter from the SEC and we were surprised to receive that because we hadn't had any correspondence with them for six months." Wong, J. Tr. 2181:25-2182:5.

a two and a half week period in February 2012.[75] And two of the Respondents, KPMG Huazhen and PwC Shanghai, received multiple requests during this same period. The alleged violations thus stem from a single, apparently choreographed move by the Division, made in full knowledge of the legal impediments Respondents faced and to bring this matter to a precipice. This factor favors the Respondents.

3. Respondents Did Not Act With Scienter.

As the *Steadman* court observed, "the respondent's state of mind is highly relevant in determining the remedy to impose." *Steadman*, 603 F.2d at 1140. In this case, the record demonstrates beyond any genuine dispute that Respondents did not act with any bad intent, much less with scienter, which is "a mental state embracing intent to deceive, manipulate, or defraud," *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 n.12 (1976). Respondents are not alleged to have deceived or defrauded anyone, and no evidence remotely suggests that they did. To the contrary, the evidence shows that Respondents have at all times been completely transparent and candid about the limitations imposed by Chinese law on the production of documents, and acted in good faith. *See supra* Section III.C.

As the Division's own witness testified, Respondents were in "a tough position."[76] Respondents' representatives testified consistently that they did not choose to violate U.S. law. Instead, they had no choice but to abide by the express directives of their home regulators.[77]

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[75] ENF Ex. 34 (Feb. 1, 2012); ENF Ex. 55 (Feb. 2, 2012); ENF Ex. 66 (Feb. 6, 2012); ENF Ex. 73 (Feb. 9, 2012); ENF Ex. 84 (Feb. 3, 2012); ENF Ex. 93 (Feb. 14, 2012); ENF Ex. 106 (Feb. 8, 2012); Respondents Ex. 408. Clearly, the transmission of the multiple requests within a period of days was not coincidental. Indeed, the requests appear to have been coordinated following a meeting between the Division and DTTC's representatives on January 31, 2012. Josephs Tr. 139:14-143:14.

[76] Boudreau Tr. 815:22-24.

[77] Chao Tr. 1376:24-1377:3 ("We have to follow the laws of PRC. But at the same time, we're getting everything ready, to the extent we could, to prepare more information in the event that something is resolved between the two regulators."); Leung Tr. 1522:12-24 ("Well, the firm did not have the choice.

Respondents' state of mind in abiding by their regulator's directives clearly weighs in their favor.

4. Respondents Are Sincere In Their Assurances Against Future Violations.

At best, this factor is inapplicable to this case. The sincerity of assurances against future violations is relevant only where past violations are based on voluntary actions by a respondent. Here, however, Respondents' actions were at all times dictated by Chinese law and directives from Chinese regulators. Respondents' ability to respond to past requests was dependent on the Chinese and U.S. regulators completing the process of developing a mechanism for sharing information. Respondents have repeatedly assured the Division that to the extent U.S. and Chinese regulators now appear to have agreed on information-sharing mechanisms, Respondents will respond to future requests in whatever manner they are instructed under Chinese law.[78] In fact, workpapers recently have been produced by the CSRC under a framework that is still in its infancy, thereby demonstrating that Respondents' assurances are sincere.[79] To the extent it applies, this factor favors Respondents.

5. The "Recognition of Wrongfulness" Factor Is Inapplicable.

The fifth *Steadman* factor—whether Respondents recognize their actions as "wrongful"—is inapplicable to a situation in which Respondents are bound by foreign legal impediments. This factor assumes that the Respondents could have chosen between "right" and

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We were told by the PRC regulator that we should not directly provide working paper to the foreign regulators."); George Tr. 1716:14-18 ("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 no decisions to be made. We have no choice in all this."); Wong, D. Tr. 1900:15-20 ("I don't actually think of it as a choice that was being made either way. I don't think we had a choice. We had a decision – we made a decision to abide by Chinese laws, that is correct, but I wouldn't term it as a choice that we had. I don't view it as a choice."); Wong, J. Tr. 2269:20-23 ("[W]e are complying with the CSRC.").

[78] *See, e.g.*, Wong, D. Tr. 1900:21-1901:5.

[79] Respondents Ex. 642; George Tr. 1636:8-23 (noting that "Longtop working papers have now been produced by the CSRC to the SEC").

"wrong" courses of action. But Respondents had no such choice in this case. As shown at the hearing, complying with the Division's Section 106 demands would have required Respondents to violate Chinese law and, thus, would have been just as "wrong" as not complying with the demands.

Moreover, the record demonstrates that Respondents were not responsible for the legal impediments they faced, but nonetheless did everything in their power to attempt to facilitate a regulator-to-regulator production. They repeatedly asked the CSRC and MOF for permission to produce documents directly to the SEC.[80] They attempted to facilitate production by, among other things, contacting the SSB and SAA.[81] And, most importantly, they kept the Division informed of the CSRC's position and implored the SEC to resolve the impasse by seeking the workpapers through the CSRC.[82]

6. Respondents Will Not Have Opportunities For Future Violations Owing To Their Occupation.

As discussed above, despite the passage of time, the CSRC now appears to be a "viable gateway" for the SEC to obtain audit workpapers from audit firms located in China. As shown at the hearing, the CSRC has developed new procedures for producing workpapers to the SEC that have the approval of the State Council. This new protocol provides the Commission with an effective means of obtaining the documents here at issue. *See supra* Sections III.A.2, III.B.2, IV. In light of these recent developments, there is nothing about Respondents' "occupation" as China-based audit firms that suggests a heightened risk of future violations of Section 106. This factor therefore favors Respondents.

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80 *See* Leung Tr. 1459:3–1464:11; Wong, D. Tr. 1872:22–1878:2; Yan Tr. 1920:20–1923:7; Ji Tr. 2089:9–2090:8; *see also supra* Section III.A.1.

81 *See supra* Section III.B.2.

82 *See supra* note 69.

C. Sanctions Would Have Substantial Negative Collateral Consequences.

In its pre-hearing brief, the Division argued that its Proposed Bar would further the Commission's mission of "protect[ing] investors, maintain[ing] fair, orderly, and efficient markets, and facilitat[ing] capital formation." ENF Pre-Hearing Brief at 66. The Division argued that its Proposed Bar would further these goals by ensuring, in particular, transparency and adequate oversight. ENF Pre-Hearing Brief at 66. But in focusing so narrowly on these particular issues, the Division has wholly failed to consider the negative consequences of its Proposed Bar, particularly to U.S. investors, the very people it is charged with protecting. Sanctions in this matter would inflict substantial harm not only on Respondents, but also on issuers, investors, and the U.S. securities markets. This impact clearly thwarts the Commission's mission and outweighs any of the Proposed Bar's supposed benefits, yet the Division refuses to concede that anything but good could come of sanctions in this matter. The Division has failed to present sufficient evidence that it has considered all possible consequences, including these plainly foreseeable consequences, and has come to a reasoned decision that sanctions would best serve the Commission's goals—and the public interest. The negative collateral consequences of the Proposed Bar—unexamined by the Division—would be substantial.

1. Respondents Perform the Vast Majority of Audits in China of U.S. Issuers.

Respondents are among the largest accounting firms in mainland China. It is undisputed that they are responsible for the overwhelming majority of the audit reports issued by PCAOB-registered firms located in China for U.S. issuers.

2. There Are No Adequate Substitutes for Respondents.

The Division's Proposed Bar would preclude Respondents from signing audit reports for issuers with securities traded on U.S. exchanges. In addition, it would prohibit them from performing audit work for an issuer where (1) "the engagement hours or fees for such services constitute 50% or more of the total engagement hours or fees [] provided by the principal auditor in connection with the issuer's audit report, or (2) the assets or revenues of the subsidiary for which Respondents are performing the audit work constitute 50% or more of the consolidated assets or revenues of the issuer. *See* ENF Pre-Hearing Brief at 65.

The Division has suggested that Respondents "may" be able to retain "other auditors," but it has failed to provide a single concrete example of an accounting firm qualified, ready, and willing to take on Respondents' clients. ENF Pre-Hearing Brief at 67 n.24. Indeed, the Division's first witness, an Assistant Director of Enforcement testified that the Division had not considered replacement auditors and did not see the need for such consideration:

Q: Ms. Josephs, are you aware of the identity of any accounting firm in China that could replace any of these Respondents in auditing financial statements filed with the United States Securities and Exchange Commission?

. . .

THE WITNESS: Yeah, I think — I think we take this one step at a time, and I don't know that there are other auditing firms in China that could do — perform the audits, and I don't know if those firms will take the position that the respondent firms have taken, that they can't produce them. So I don't know that there is an answer to your question.

. . .

Q: Well, my question, just to be clear, was, are you aware of the identity, the name of any such firm that can replace any of these Respondents?

A: I think I answered that question.

Q: You didn't provide any names.

A: I don't have a name. I don't have a name.

Q: Is it fair for me to assume that you can't identify by name any such firm?

A: I don't know —

. . .

THE WITNESS: I don't know that I need to know another name per se. If another firm shows up and is able to do it, then I don't have a problem with that.

BY MR. WARDEN:

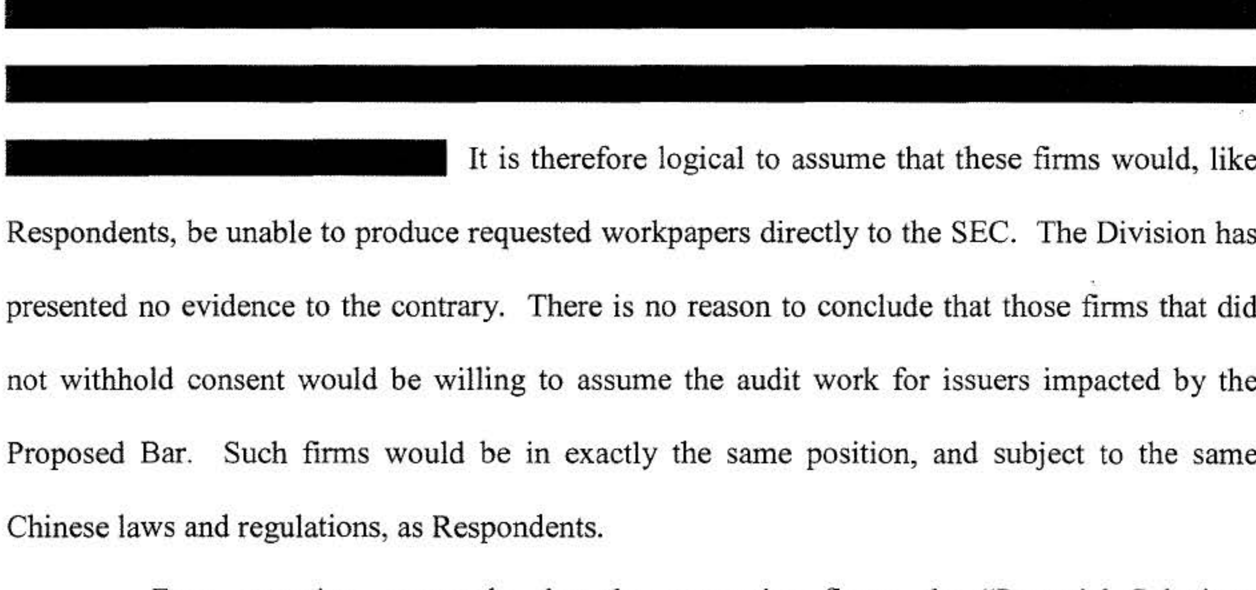
Q: So you don't know the name.

A: I don't know why I would.

Josephs Tr. 163:21-164:21.

In fact, the evidence adduced at the hearing shows that there are no adequate substitutes for Respondents in China. [redacted]

[redacted]



It is therefore logical to assume that these firms would, like Respondents, be unable to produce requested workpapers directly to the SEC. The Division has presented no evidence to the contrary. There is no reason to conclude that those firms that did not withhold consent would be willing to assume the audit work for issuers impacted by the Proposed Bar. Such firms would be in exactly the same position, and subject to the same Chinese laws and regulations, as Respondents.

Even assuming, *arguendo,* that the consenting firms—the "Potential Substitute Firms"[83]—could substitute for Respondents, those firms are woefully inexperienced in auditing U.S. issuers when compared to Respondents.

[83] Firms that could potentially substitute for Respondents ("Potential Substitute Firms") are those PCAOB-registered firms that consented to comply with the PCAOB guidelines in Item 9 on their most recent Form 2 or in Item 8 on their Form 1. Firms that did not consent cannot be considered viable substitutes. Simmons Expert Report ¶ 16. As previously discussed, however, the term "Potential Substitute Firms" perhaps is a misnomer because there is no evidence that even those firms that submitted consents would be able to comply directly with U.S. regulators' requests.

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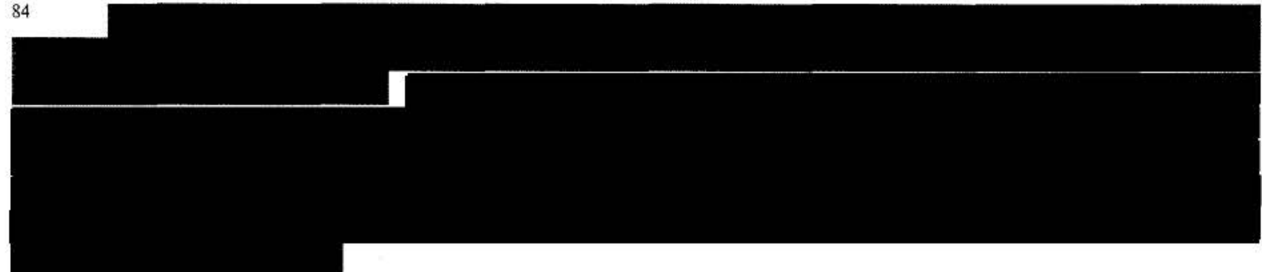

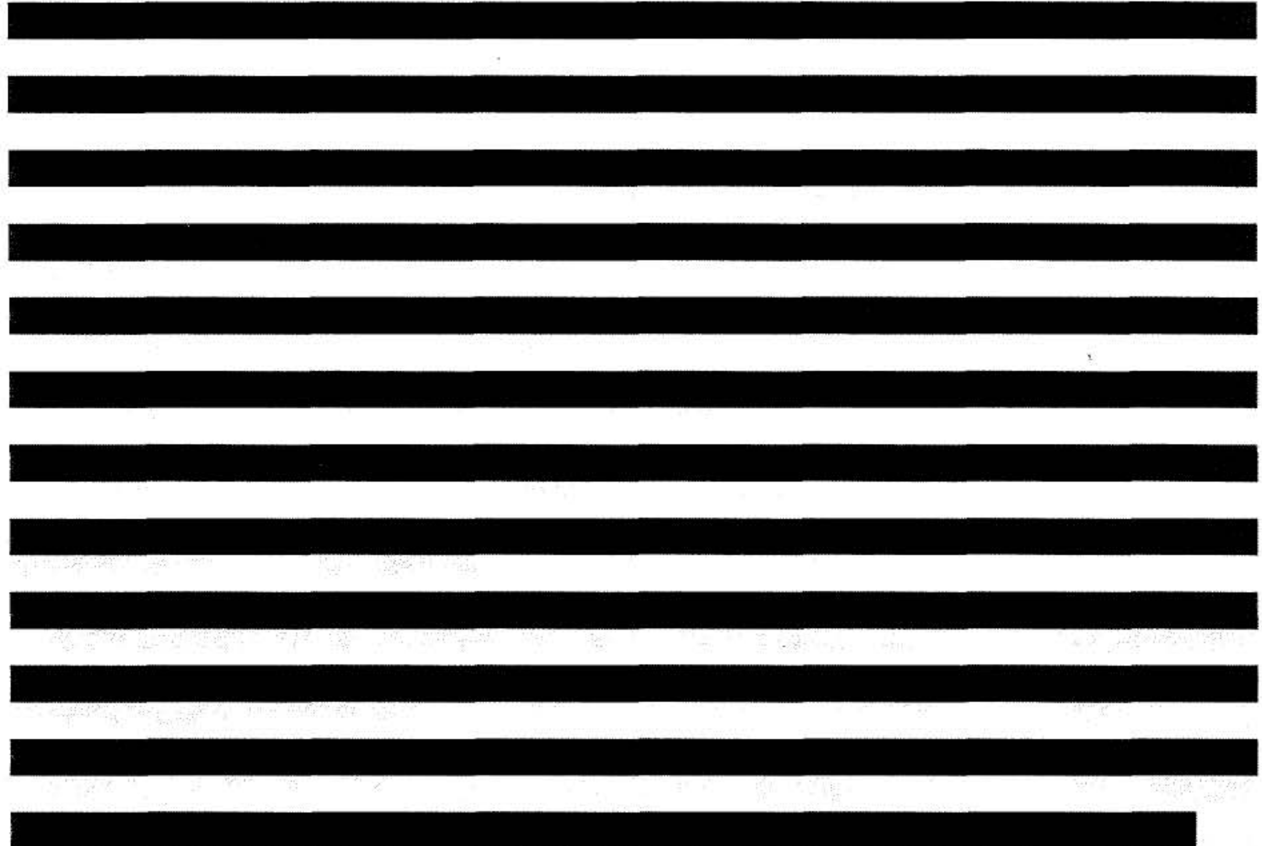

It is uncontroverted that the size and experience of an accounting firm matters when it comes to audit quality. Simmons Expert Report ¶ 39. As the Division's own expert witness, Dr. Chyhe Becker, conceded, larger audit firms have a reputation for performing higher quality audits than smaller firms. Becker Tr. 2625:14-24. In addition, larger firms are able to invest more in training and technology, giving them greater industry expertise. Simmons Expert Report ¶¶ 39, 44. Industry expertise in turn directly affects an auditor's ability to assess audit risk and detect errors and misstatements. Simmons Expert Report ¶ 43. This is in addition to the simple

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risk that replacement firms will attempt to do too much with too little, staffing large-scale audits with small-scale teams.

3. Accounting Firms Based Outside of Mainland China Are Not Viable Substitutes for Respondents.

As discussed in Section III.A above, the Division appeared to suggest during the hearing that Respondents could have produced the requested workpapers without suffering any consequences or, alternatively, that there are other accounting firms that would have been able to do so. For the reasons previously described, those suggestions, including their implicit invitation to violate Chinese laws and regulations, are groundless.

In fact, the evidence demonstrates that, to the extent any firms produced workpapers to the Commission that actually had been created in mainland China (and the Division has not offered evidence of such a production), they presumptively did so in violation of Chinese laws and regulations. *See supra* Section III.A.4. To the extent that there was any question that Regulation 29 also applied to Hong Kong-based firms that performed audit work within mainland China (such as the Crowe Horwath LLP Hong Kong affiliate, which may have performed the audit work and created the workpapers Crowe Horwath produced to the SEC, Hubbs Tr. 480:12-22, 545:1-546:25), the testimony of Jacqueline Wong and the release prepared by the Hong Kong Institute of Certified Public Accountants ("HKICPA") containing a letter

from the MOF and a link to Regulation 29, leave no doubt on that issue: Hong Kong accounting firms are subject to the requirements of Regulation 29 for any audit work that they perform in mainland China.[86] As Professor Tang explained regarding a China issuer that apparently produced documents directly to the SEC without obtaining prior approval from the CSRC, sending China workpapers directly to the SEC was a "huge risk" since that action was in violation of Regulation 29 and Chinese law. Tang Tr. 2470:17-25, 2471:1-19.

Therefore, to the extent that the Division continues to contend that the enormous gap that would be created by barring Respondents from performing audit services for the [redacted] the Respondents currently assist could be filled by Hong Kong firms or firms like Crowe Horwath that chose to ignore Chinese laws and regulations and produce documents directly to the SEC without notifying the CSRC and MOF, that contention is groundless, and seems to suggest that disregard of relevant Chinese laws and regulations by potential replacement firms would be acceptable to the Division and should be to the Court. Plainly, the suggestion of condoning violations of Chinese law cannot be seriously considered.

4. Issuers Impacted by the Proposed Bar Have a Substantial Aggregate Market Capitalization.

[redacted]

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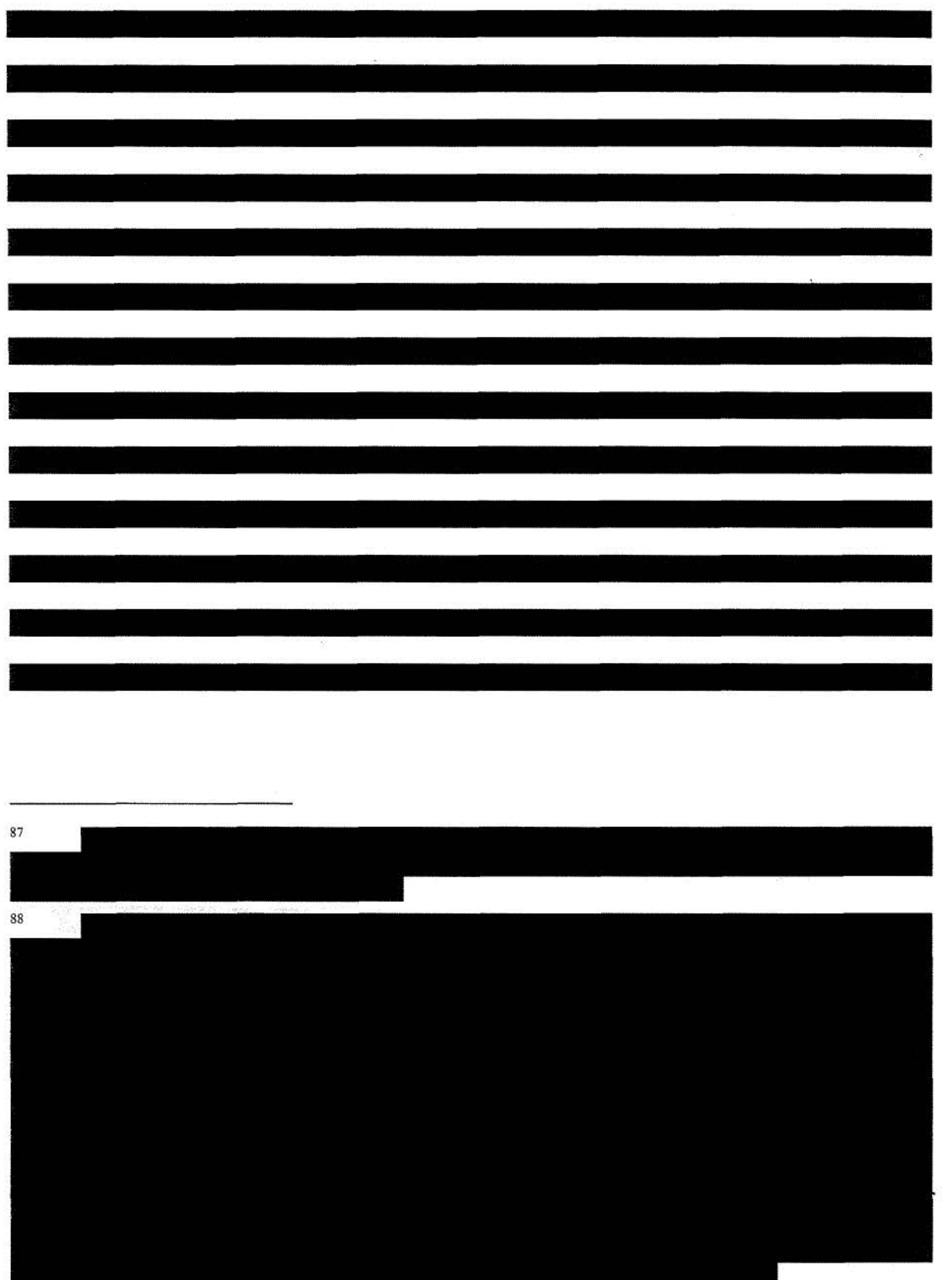
[86] Wong, J. Tr. 2204:1-6; Respondents Exs. 652-652E. During cross-examination, a witness for KPMG Huazhen testified that Hong Kong firms may obtain a temporary license from the MOF for a five-year period. Wong, J. Tr. 2201:8-14. U.S.-based firms, however, are eligible for only a six-month license. More importantly, as the witness for KPMG Huazhen testified, the audit materials of a foreign firm with a temporary license still are required to be maintained in mainland China. Wong, J. Tr. 2203:25-2204:6. Also, the PCAOB has recognized heightened risks associated with performing audit work in emerging markets, most notably China, due to local business practices and cultural norms. PCAOB, Staff Audit Practice Alert No. 8, Audit Risks in Certain Emerging Markets (Oct. 3, 2011), available at http:// pcaobus.org/Standards/QandA/2011-10-03_APA_8.pdf.



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5. **Issuers Impacted by the Proposed Bar Would Incur Substantial Costs if Forced to Switch Auditors.**

If the issuers described above were deprived of the auditors they selected and their shareholders approved, they would suffer significant costs. Issuers generally incur costs whenever they change auditors, including search costs, renegotiation costs, and the time to educate a new auditor. Simmons Expert Report ¶ 41. The Division's own expert witness, Dr. Becker, did not dispute that changing auditors under any circumstances can be time consuming, costly, and disruptive. Becker Tr. 2624:20-25.

Switching from a large, well-known auditor to a smaller, less well-known auditor can also lead to an increase in issuer debt costs and depressed share prices. Simmons Expert Report ¶ 40. The same is true when companies switch from auditors with specialized industry knowledge to auditors without relevant industry experience, and when companies switch from a "Big 4" firm to a non-Big 4 auditor lacking industry specialization. Simmons Expert Report ¶ 43. Dr. Becker did not dispute those conclusions. Becker Tr. 2626:15-2628:5. As shown *supra*, it is undisputed that Respondents have experience issuing audit opinions across a wide variety of industries, while any Potential Substitute Firms do not. Simmons Expert Report ¶ 44. U.S. investors would ultimately bear the costs associated with this switch, as well as the reduction in expertise and quality that Respondents possess.

6. **The Proposed Bar Will Very Likely Could Force Impacted Issuers to Delist or To Be Delisted.**

If the issuers impacted by the Proposed Bar are unable to engage new auditors to replace Respondents (or are unable to engage them quickly enough to file timely financial statements), they could be deregistered and/or delisted from U.S. exchanges. While

deregistration is not automatic—the Commission must choose to initiate deregistration proceedings, *see* 15 U.S.C. § 78*l*(j)—other consequences are and are largely outside of the Commission's control. For instance, under exchange rules, the failure to timely file annual reports containing audited financial statements with the Commission automatically sets in motion procedures that may result in suspension and delisting of the issuer's securities. *See* NASDAQ Equity Rule 5810(c)(2); NYSE Listed Company Manual §§ 802.01E, 804. It bears noting that the Proposed Bar could go into effect late in the audit process, leaving issuers little time to engage new auditors before annual reports are due, and thus magnifying this risk.

As discussed above, however, the reality is that impacted issuers would be faced with a radically diminished pool of available accountants, all of whom undoubtedly are aware of these proceedings and the attendant risks of auditing U.S. issuers. The Division has flatly failed to prove that the firms would be willing to take on Respondents' clients, or that clients would want them. While the likelihood that impacted issuers would fail to find substitute auditors cannot be determined with any specificity, the risk must be regarded as quite high in light of these facts. And if these U.S. issuers cannot quickly find alternative auditors, their securities are at risk of delisting in processes largely outside of the Commission's control. While the Division has challenged Respondents to quantify the likelihood of this scenario, it cannot deny that delisting could occur, or that it is likely for a significant number of issuers. *See, e.g.,* ENF Pre-Hearing Brief at 67; Becker Tr. 2639:6-16.

7. Delisting Would Harm U.S. Investors.

It is undisputed that academic research shows that companies that delist and transition to the "Pink Sheets" or other over-the-counter markets experience a significant decline in share price. Simmons Expert Report ¶ 45. Dr. Simmons demonstrates that the most relevant literature predicts an average drop of 50 percent for stocks listed on the NYSE and 19 percent for stocks listed on the Nasdaq. Simmons Expert Report ¶ 45.

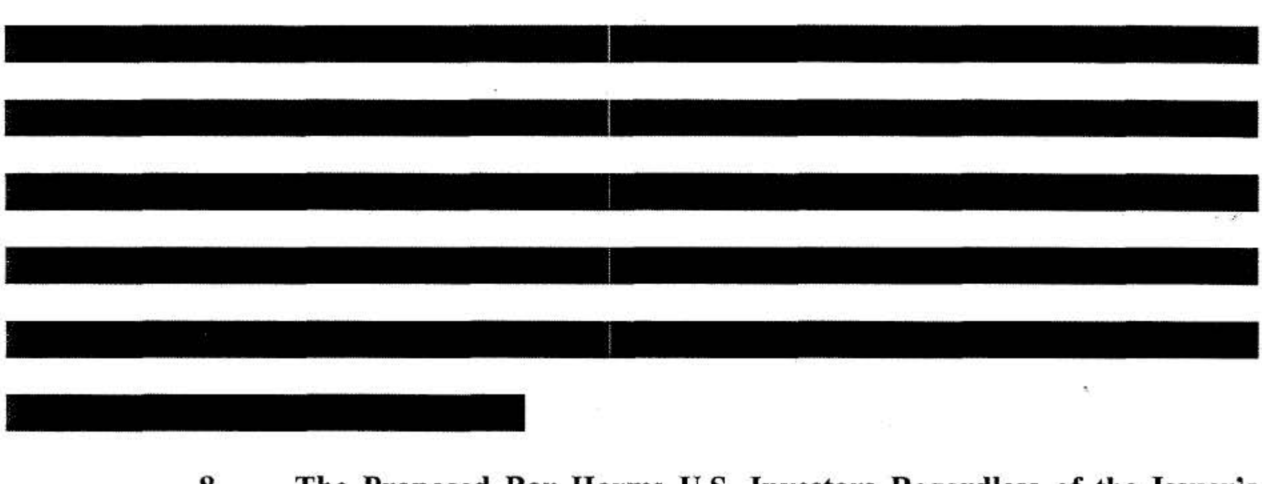
Both in her report and in her testimony, Dr. Becker attempted to make the argument that issuers impacted by the Proposed Bar would be "voluntarily" delisting from U.S. exchanges because they had the "option" of changing auditors; similarly they would be "voluntarily" delisting because they would have the "option" of listing on non-U.S. exchanges or on the Pink Sheets. Becker Report ¶ 37, Becker Tr. 2630:15-2632:15. Even though Dr. Becker conceded that those issuers would not "voluntarily select to be in this situation," she nevertheless opined

that delisting here *must* be a "voluntary" decision. Becker Tr. 2641:1-24, 2643:10-19; Becker Report ¶ 37. But, for the reasons already described, affected issuers would have no choice in deciding whether the auditors they selected could provide reports for their use in the U.S., and might very well be unable to find substitute auditors. And listing on the Pink Sheets or on a foreign exchange does not diminish the fact that issuers delisting from regulated U.S. securities exchanges suffer a substantial financial impact. Dr. Becker's argument that the issuers who were forced to delist should be treated like others who made a voluntary choice is no more than semantic sophistry and should be disregarded.

Even beyond the voluntary/involuntary distinction, Dr. Becker's studies are wholly irrelevant to the matter at hand. Unlike Dr. Simmons, Dr. Becker never reviewed the record in this case, did not conduct any independent research, and did not perform any analysis of her own on the subjects. Becker Tr. 2588:4-2589:2. She simply reviewed studies that, upon comparison with this matter, have no relevance. One study, for instance, focuses on companies that chose to delist from the Over-the-Counter Bulletin Board rather than voluntarily comply—for the first time—with securities regulations. Becker Expert Report ¶¶ 18, 34. Another found that Chinese state-owned enterprises may realize reduced benefits from listing on a U.S. exchange. Dr. Becker concludes from that result that the state-owned enterprises would likely realize smaller-than-average adverse effects from delisting. Becker Expert Report ¶ 38. Not only is this a methodological leap, but the study is not even applicable to the many issuers impacted by the Proposed Bar that are not state-owned.

Further, Dr. Becker opined that Dr. Simmons' studies were inappropriate because they focused on delisting of companies in financial distress. Becker Expert Report ¶ 31; Becker Tr. 2585:5-21. This opinion is flawed for a number of reasons.

During cross-examination, Dr. Becker conceded that failure to file audited financial statements would fall under this category, just like the issuers that suffered financial distress. Becker Tr. 2645:19-2646:3. In fact, Dr. Becker admitted that a study she relied on to suggest that delisting would not have the impact Dr. Simmons predicted actually identified as "severe" a governance issue, which she conceded included failing to file financial statements. Becker Tr. 2643:20-2646:3. Thus, Dr. Becker's analysis is seriously flawed, and fails to support the substantially lower impact that she contends delisting would have here. In any event, this matter is unprecedented, hence no studies have looked at the effect of delisting on securities whose issuers are unable to find qualified auditors. Therefore studies focused on involuntary delisting, including issuers delisted for governance reasons that Dr. Simmons relied upon are clearly the more relevant guideposts in this matter.



8. **The Proposed Bar Harms U.S. Investors Regardless of the Issuer's "Base of Operations."**

The Division also appears to suggest that the Proposed Bar would be acceptable because it would have only a "limited impact" on "the ability of large multinational issuers to obtain necessary audit services from Respondents." ENF Pre-Hearing Brief at 67.

[89]

9. **The Full Negative Impact of the Proposed Bar Could Continue to Grow.**

The Division has not made clear whether its proposed "50 Percent Role Bar" would apply only to Respondents' audit clients as they stand today or whether it would also apply to clients whose audit work or assets and revenues exceed the 50-percent threshold in the future. Assuming the bar will apply to a company once it reaches that threshold, the proposed sanctions have the potential to impact far more companies—and thus U.S. investors—in the future, and introduce enormous uncertainty into the market.

Respondents do not dispute that workpapers can play an important role in government investigations, that Respondents will be impacted by the Proposed Bar, or that regulation and disclosure can bring benefits to securities markets. But the Division seems to have gone out of its way to ignore the myriad negative consequences of sanctioning Respondents in this matter—negative consequences that far outweigh the amorphous benefits the Division cites and which eclipse in severity the impact to Respondents themselves. Respondents are not alone in their concerns about the impact of the proposed sanctions, nor are those concerns overstated. As noted in a letter from the U.S. Chamber of Commerce shortly after the OIP, "A failure to reach an agreement could adversely affect investor confidence in the accuracy and

reliability of corporate financial statements. Lowered investor confidence typically results in lowered valuations of public companies, which can reduce the opportunity for new companies to go public. These developments could harm the capital markets for years to come." Ltr. from David L. Hirschmann, President and CEO, Center for Capital Markets Competitiveness, U.S. Chamber of Commerce, to His Excellency Guo Shuqing, Chairman, CSRC and The Honorable Elisse Walter, Chairman, SEC (Dec. 18, 2012), *available at* http://www.uschamber.com/issues/letters/2012/letter-securities-and-exchange-commission-regarding-china.

In addition, while the Division has suggested that the impact of the proposed sanctions on Respondents relates only to the revenues that the firms have earned from the work that they would be prohibited from performing under the Proposed Bar, the evidence in the record demonstrates that the consequences to the firms, and the public, would go well beyond any immediate revenue decline. Indeed, the firms' significant investment in the impacted practice would be severely jeopardized to the detriment of the firms and their personnel, not to mention reputational damage and impact on audit quality.

Since Respondents first opened their offices in mainland China, in most cases in the early 1990s, *see* Leung Tr. 1398:22-24, and particularly since they registered with the CSRC, the firms have taken dramatic steps to expand their personnel and services, and improve the quality of their work. As Respondents Exhibit 605 reflects, the growth in the number of offices and personnel employed by Respondents from the time they registered with the PCAOB to the present shows a nearly five-fold growth in personnel, most significantly of those with CPA or equivalent licenses. Respondents have also expanded within China, with an average of six offices per firm at the end of 2012. *Id.* As several of their witnesses explained, Respondents

have attempted to build full-service accounting practices in the PRC, and have made substantial investments in training and dedication of resources to ensure that each of the firms offer the highest quality professional services in China. *See, e.g.*, Chao Tr. 1319:9-25 (describing investment in this practice).

Respondents have invested substantial monies and resources, and established areas of expertise in financial services, capital markets and other areas to meet the current and future needs of Chinese businesses. Chao Tr. 1317:1-1319:25; Leung Tr. 1483:8-1488:7; Ji Tr. 2051:7-2152:17. EYHM, for example, established a Capital Markets group in Shanghai, led by experienced partners with expertise in U.S. GAAP and GAAS, and SEC registration and compliance. Leali Tr. 1750:11-1753:3. It also trained hundreds of its CPA-equivalent staff to perform U.S. audit work. Leung Tr. 1487:4-7.

As described above, there is simply no substitute in China for the expertise that Respondents have developed, and issuers who have come to rely on the Respondents and their global reputations would simply be left without any comparable auditing services in China. That loss will cost the issuers and their shareholders in many significant ways, as the Division's expert, Dr. Becker, acknowledged. Becker Tr. 2624:20-2628:5. But the impact of the proposed sanctions, which is severely harmful, does not end there.

First, as several of the witnesses testified, there are serious grounds for concern about the quality of the audit work that would be performed if the firms that have devoted huge resources to the development and training of auditors knowledgeable and capable of performing U.S. GAAP and GAAS procedures are removed. *See, e.g.*, Chao Tr. 1317:1-1319:25. Neither of the Division's experts challenged the fact that, in the absence of Respondents, there is a huge gap in the number of audit firms that have performed audits on U.S. issuers.

Second, and distinct from the financial and personnel impact on Respondents themselves, the Proposed Bar would also impact Respondents' network firms. Those multinational clients of the network firms would lose their China audit firms, and would have no substitute to perform component work essential to the preparation of consolidated financial statements. Chao Tr. 1318:4-18. Those clients, like the U.S. issuers Respondents currently audit, need the capability of experienced professionals, which they would lose. *Id.*

Third, there is real reputational damage that Respondents and their networks will suffer from the Proposed Bar. Many clients will not understand that the bar is the result of a conflict of laws and does *not* reflect that the firms performed deficient or substandard work. Clients who lack that knowledge could decide not to use Respondents for any audit work, not just for U.S. audits. In fact, Mr. Ji expressed precisely that concern: "Dahua's clients would mistakenly think that Dahua was sanctioned because of its poor audit quality . . . this would cause negative impact on Dahua's reputation." Ji Tr. 2096:21-2098:9. That is not hypothetical concern, however. It has already happened. As Mr. Ji explained, Dahua has stopped taking new clients listed in the U.S. market, and existing clients listed in the U.S. markets terminated all their contracts with Dahua. As he stated, "[t]he main reason for this is that Dahua's clients were concerned that this SEC suit and the potential consequences will bring them trouble if they continue to work with Dahua so they were not willing to work with Dahua again." *Id.*

Finally, there is no evidence that Respondents have failed to provide competent, professional service to U.S. issuers, or anyone else. There is instead ample evidence to show that Respondents detected most of the issues that the Division investigated, and acted responsibly in addressing those matters. To remove Respondents from providing the best available service to U.S. issuers and their investors merely because they could not produce documents while the

conflict between the Commission and the CSRC existed imposes huge and unnecessary sanctions on those, including Respondents, who have done nothing to merit those severe consequences.[90]

D. **The Arbitrariness of the Proposed Sanctions Underscores Their Inappropriateness in this Matter.**

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[90] The growth and development of Respondents' China practices also belies the Division's contention that Respondents knew that these sanctions were possible from the time they registered with the PCAOB, and performed the audit work for U.S. issuers just to make money. Certainly, no rational actor would invest in five-fold growth, training and quality improvement expecting that they would be caught in the middle of a legal conflict that could not be resolved, and face a bar such as that proposed here.

The Division has insisted that "the most significant harm" that resulted from Respondents' conduct, and which the Division asserts justifies its proposed sanction, is "the inclusion, in publicly filed financial statements, of affirmative representations to U.S. investors that could not in fact be verified." ENF Pre-Hearing Brief at 64. With respect to PwC Shanghai, it is undisputed that this alleged harm never transpired since PwC Shanghai never prepared, furnished, or issued any audit reports for Client H or Client I. The same is true with respect to Clients B, E and G, which are former clients of EYHM, KPMG Huazhen, and DTTC. The unmoored nature of the proposed sanctions to the conduct of Respondents underscores the point that this case is not an appropriate case for sanctions of any kind, let alone ones that sweep as broadly and indiscriminately as the ones the Division proposes.

E. **Imposing Sanctions Against Respondents Would Not Have Any Remedial Effect.**

Under Rule 102(e), any sanction imposed must be remedial in nature, not punitive. *See McCurdy v. SEC*, 396 F.3d 1258, 1264 (D.C. Cir. 2005). However, the sanctions requested by the Division in this case will do nothing to remedy the Division's difficulties in obtaining workpapers located in China—either from Respondents or from any accounting firms that might replace them—and should be rejected.

As an initial matter, Rule 102(e) does not give the Commission the authority to order the production of documents. Indeed, every Division witness who was asked conceded that these proceedings were not intended to and would not result in the production of workpapers to the Commission. *See, e.g.,* Rana Tr. 224:1-4; Peavler Tr. 289:20-290:23; Weinstein Tr. 680:21-23. Simply put, these proceedings will do nothing to "remedy" Respondents' inability—under Chinese law and express directions from the Chinese regulators—to produce workpapers directly to the Commission.

More importantly, sanctioning Respondents in this case will do nothing to assure that the Commission will be able to obtain workpapers from China in the future. As discussed at length above, Respondents did not fail to produce documents in response to the Commission's Section 106(e) requests because they were obstinate, or predisposed to flouting their obligations,

or even just "bad." They did so because complying with the requests would have violated Chinese law and the express instructions of the Chinese government authorities.

The Division asserts that barring Respondents is a necessary "remedy" for Respondents' failure to produce documents directly to the Commission. But it has offered no reason—let alone any evidence—suggesting that other audit firms operating in China would be in any different position than Respondents. The closest it comes is to speculate that "[i]t may be possible for U.S. issuers that are foreclosed from hiring Respondents to retain other auditors who can comply with the U.S. securities laws, including by producing audit workpapers in response to Section 106 requests." ENF Pre-Hearing Brief at 67 n.24. As discussed *supra,* the Division failed to introduce any evidence to support that supposition, while there is ample reason to believe that other China-based accounting firms will be unwilling to take on Respondents' clients. And to the extent that non-China accounting firms have performed audit work in China and sent the resulting workpapers directly to the Division, they likely violated Chinese law. If the Division hopes that sanctioning Respondents will "remedy" their failure to produce documents—and thereby protect U.S. investors—that "remedy" likely extend to all other accounting firms operating in China.

F. The Proposed Sanctions Conflict with Past Commission Policies and Practices.

Imposing sanctions under these circumstances, in which Respondents at all times have acted in good faith and were indisputably subject to foreign legal impediments, also would be inconsistent with the Commission's longstanding practice of working with foreign counterparts to resolve such matters. The SEC has a long and successful history of working collaboratively with foreign regulators to mitigate these issues. Atkins Expert Report ¶ 11. The Division's continued pursuit of sanctions despite significant progress by the CSRC in just the last

month flatly contradicts over thirty years of Commission policy and practice. Indeed, this unexplained departure is impermissibly arbitrary and capricious.[91]

The policy of the SEC, when faced with conflicts between its programmatic needs and foreign legal impediments, has traditionally been to turn to bilateral or multilateral cooperative agreements to advance investor protection while working with foreign counterparts. Atkins Expert Report ¶ 20. As then-Commissioner Mary Schapiro explained in 1989, "An MOU allows the Commission to avoid the problems of foreign secrecy and blocking statutes, and permits us to obtain the information we need without risk of causing an international incident." Mary L. Schapiro, Comm'r, U.S. Sec. & Exch. Comm'n, *Enforcement Initiatives of the SEC: 1989* (Sept. 20, 1989), *available at* http://www.sec.gov/news/speech/1989/092089schapiro.pdf. More than two decades later, then-Chairman Schapiro continued to encourage cooperation with foreign regulators to pursue the Commission's enforcement aims. Respondents Ex. 241, 6-7 (Ltr. From SEC Chairman Mary L. Schapiro to Hon. Patrick T. McHenry, Chairman of the Subcomm. on TARP, Fin. Servs., & Bailouts of Pub. And Private Programs, Comm. on Oversight and Gov't Reform (Apr. 27, 2011)). Since 1982, the Commission has negotiated and executed bilateral enforcement MOUs with its counterparts in 20 countries. *See* U.S. Sec. & Exch. Comm'n, International Enforcement Assistance,

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[91] As further evidence of its arbitrariness, the Division's course in these proceedings is inconsistent with the SEC's ongoing practice of allowing—as recently as this year—initial public offerings by foreign private issuers that are audited by these same firms. In the past, the Division of Corporation Finance has exercised its authority to regulate initial public offerings on the basis of public interest considerations. *See* Louis Loss, Joel Seligman & Tony Parades, Securities Regulation 842 (4th ed. 2006) (describing "the Commission's use of its acceleration power to enforce its view that indemnification of an officer or direction (or a person in control of the issuer) against statutory liabilities is unenforceable"). Here, however, the Division attempts at once to assert that Respondents' inability to produce documents so severely endangers investors as to warrant disbarment, while at the same time permitting new China-based companies to register with Respondents serving as their auditors. This contradictory position defies reasonable explanation—and the Division has made no effort to offer any.

https://www.sec.gov/about/offices/oia/oia_crossborder.shtml (last modified Nov. 13, 2012). These agreements have yielded substantial results. For instance, in fiscal year 2011, the SEC made more than 770 requests to foreign authorities and responded to nearly 500 requests. *See id.*

As a general rule, "an agency changing its course must supply a reasoned analysis indicating that prior policies and standards are being deliberately changed, not casually ignored." *Greater Bos. Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970) (also making clear that where "an agency glosses over or swerves from prior precedents without discussion it may cross the line from the tolerably terse to the intolerably mute"). In addition, the agency "must show that there are good reasons for the new policy." *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009). "[A]n agency acts arbitrarily and capriciously when it abruptly departs from a position it previously held without satisfactorily explaining its reason for doing so." *Wis. Valley Improvement v. FERC*, 236 F.3d 738, 748 (D.C. Cir. 2001). These prerequisites are conspicuously absent here. Prior to the initiation of these proceedings, the Commission consistently refrained from forcing foreign public accounting firms to violate the laws of their home country in order to comply with an SEC document demand. But the Division has offered no explanation for why it seeks to sanction Respondents despite the availability of a viable regulator-to-regulator solution.

The record demonstrates that the OIA and Division prematurely concluded that "the CSRC was not a viable gateway for the delivery of audit work papers." Arevalo Tr. 1045:22-1046:4. This conclusion has proven to be incorrect. Whatever prior delays it may have encountered in its negotiations with the CSRC, the Division can no longer credibly contend that a sovereign-to-sovereign solution is not feasible in this case. As established during the hearing, the CSRC produced directly to the SEC audit workpapers related to one of the three

investigations for which the Division requested assistance. Respondents Ex. 631; *see also* Respondents Ex. 633 (Notice to the Court, U.S. Securities and Exchange Commission v. Deloitte Touche Tohmatsu CPA Ltd., 11 Misc. 512 GK/DAR (D.D.C. July 10, 2013). The record also reflects that other workpapers, including workpapers related to at least two of the issuers included in these proceedings, are on the cusp of being produced to the Division. The CSRC, therefore, offers a viable gateway for obtaining the requested materials, putting Respondents in *exactly the same position* as those firms in the more than 50 countries with which the SEC has devised workable arrangements for the exchange of documents. In light of these recent developments, there is simply no basis whatsoever for the Commission's decision to penalize Respondents instead of pursuing regulator-to-regulator cooperation. *See Transactive Corp. v. United States*, 91 F.3d 232, 237 (D.C. Cir. 1996) ("A long line of precedent has established that an agency action is arbitrary when the agency offered insufficient reasons for treating similar situations differently.") (citing *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto Ins. Co.*, 463 U.S. 29, 57 (1983) (citation omitted)). The Division's persistence in its current course is unprecedented and smacks of arbitrariness.

Indeed, with respect to four of the five Respondents, the Division elected to forego the Commission's preferred course of action and did not request the CSRC's assistance. As shown at the hearing, OIA advised the Division's personnel that it "might not be worth their time and effort" to submit requests for assistance to the CSRC. Arevalo Tr. 975:11-23. As one Division staff member testified, "based on [another investigative team's] 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." Rana Tr. 182:20-183:14. The Division's decision is at odds with the Commission's longstanding

"preference [] to work with the CSRC in a mutual partnership to obtain the information we need for our cases from China." ENF Ex. 241, at 3.

The Division's attempt to reverse its historic practice retroactively and without explanation also stands in stark contrast to evidence of the PCAOB's parallel diplomatic resolution of identical issues. The PCAOB continued to pursue diplomatic means and approximately four months ago, the PCAOB and CSRC executed an MOU expressly addressing the production of audit workpapers. *See* Respondents Exs. 273, 274, 277. Article IX of the MOU expressly provides that the PCAOB may share confidential information obtained in connection with the MOU with the SEC. After the signing of the MOU, the PCAOB requested certain audit workpapers from Respondents through the CSRC, all of which workpapers involved clients at issue in this proceeding. The CSRC, in turn, has begun the process of requesting those audit workpapers from at least two of the Respondents, attaching the original PCAOB requests to its own requests. *See, e.g.,* Respondents Ex. 632A; Leung Tr. 1479:9-12 (explaining that EYHM received a request regarding Client C from the PCAOB through the CSRC); Respondents Ex. 650A; Yan Tr. 1926:16-25 (explaining that KPMG Huazhen received a request from the CSRC on behalf of the PCAOB regarding Clients D and F). All of these developments are consistent with the preliminary stages of a successful cooperative framework. Sanctioning Respondents when the Division appears to be on the cusp of obtaining the requested workpapers would be unfair, inequitable, and impermissibly arbitrary and capricious. Moreover, such action may undermine the Commission's goodwill with the CSRC and may jeopardize the CSRC's cooperation in the further production of audit workpapers.

VII. CONCLUSION

For the foregoing reasons, the Division failed to meet its burden of proving that Respondents willfully refused to comply with the Section 106 requests, and in any event, any

sanction against Respondents in these circumstances would be impermissibly arbitrary and capricious, unwarranted, and contrary to the public interest.

Dated: August 30, 2013

Respectfully submitted,

(*Signatures on next page*)

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