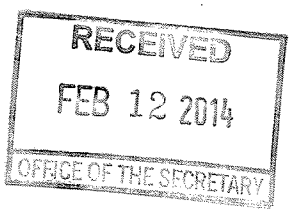
ADMINISTRATIVE PROCEEDING
FILE NOS. 3-14872, 3-15116

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.

RESPONDENTS' PETITION FOR REVIEW OF ALJ'S INITIAL DECISION

Date: February 12, 2014

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Pursuant to Rule 410 of the U.S. Securities and Exchange Commission's (the "SEC" or "Commission") Rules of Practice, Respondents Ernst & Young Hua Ming LLP ("EYHM"); KPMG Huazhen (Special General Partnership) ("KPMG Huazhen"); Deloitte Touche Tohmatsu Certified Public Accountants Ltd. ("DTTC"); and PricewaterhouseCoopers Zhong Tian CPAs Limited Company ("PwC Shanghai") (collectively, "Respondents") hereby petition the Commission for review of the Initial Decision rendered by Administrative Law Judge ("ALJ") Cameron Elliot in this matter on January 22, 2014 (the "Initial Decision").

INTRODUCTION

The Initial Decision addresses an issue of first impression and of paramount importance to accounting firms around the world, the international capital markets, and, perhaps most importantly, relations between the SEC and its counterpart in China, the China Securities Regulatory Commission ("CSRC"). Specifically, the Initial Decision considers whether Respondents violated Section 106 of the Sarbanes-Oxley Act of 2002 ("SOX")—and therefore may be barred from practice before the Commission—because they were unable to produce audit workpapers directly to the SEC without violating the laws of their home country and exposing themselves to the risk of severe sanctions, and irrespective of their good faith. In answering that question in the affirmative, the Initial Decision misconstrued the operative legal standard in this proceeding—which provides that only a "willful refusal to comply" with an SEC request for audit workpapers or other documentation constitutes a violation of SOX. *See* 15 U.S.C. § 7216(e). It also ignored critical exculpatory evidence, and proposed sanctions that are inconsistent with the law and which the SEC Division of Enforcement (the "Division") itself argued are manifestly *not* in the public interest. The implications of this flawed decision reach far beyond this case, and require full review by the Commission.

The Initial Decision is replete with erroneous conclusions of law and findings of fact, and, at minimum, plainly "embodies an exercise of discretion or decision of law or policy that is important and that the Commission should review." *See* Commission Rules of Practice 411(b)(2))., 411(e)(2). *First*, as the first decision by any tribunal ever to construe Section 106, the Initial Decision makes several dispositive errors of law, including adopting an incorrect construction of Section 106(e)'s "willful refusal" standard and finding that the standard has been satisfied here. The "willful refusal" standard can be satisfied only by proof of bad faith or conscious wrongdoing. Yet, the Initial Decision adopts a flawed standard for violations of Section 106 based largely on a *different* part of SOX, which applies only to requests by the Public Company Accounting Oversight Board ("PCAOB"), and *not* the SEC. Initial Decision at 89. This is not what Congress intended when it carefully calibrated the plain language of Section 106 to account for principles of international comity. *Second*, the Initial Decision refuses to consider undisputed evidence that several sets of the workpapers at issue were produced by the CSRC to the SEC, and the CSRC is assisting the SEC in obtaining the remaining requested workpapers. *See id.* at 110; *see also* Respondents' Motion for Leave to Adduce Additional Evidence Pursuant to Commission Rule of Practice 452. The Initial Decision specifically held that such evidence is "potentially exculpatory," but nonetheless declined to consider that evidence, basing its analysis on factual predicates that are false and inconsistent with this critical evidence. *Id.* *Third*, the Initial Decision proposes a sanction—the suspension of every major audit firm in China—that is inconsistent with law, unsupported by the record, threatens the public interest, and is completely unnecessary given the fact that the SEC and CSRC are actively cooperating and the SEC has (or imminently will have) access to all of the workpapers it has requested. *Id.* at 102-09.

Accordingly, Respondents seek review of following findings and conclusions in the Initial Decision:

- Contrary to the plain language, structure, and the history of Section 106, as well as the principle of prescriptive comity, the Initial Decision concluded erroneously that "willful refusal" means merely "'choosing not to act after receiving notice that action was requested,' without regard to good faith." Initial Decision at 88-97. Properly construed, the willful refusal standard requires proof of conscious wrongdoing or a lack of good faith—an issue the Initial Decision never considered in the context of Section 106(e)'s "willful refusal" standard.

- The ALJ erred in permitting the Division to initiate this proceeding without first seeking judicial enforcement of the underlying Section 106 requests, as is required by both Section 106 itself, notions of due process, and the Administrative Procedure Act, as well as in holding more generally that the enforceability of the Section 106 requests is "irrelevant." *Id.* at 101.

- The Initial Decision's holding that Respondents "willfully refused" is inconsistent with the U.S. Supreme Court's decision in *Safeco Insurance Co. of America v. Burr*, 551 U.S. 47 (2007), because Respondents' legal obligations under Section 106 were not sufficiently clear before this case of first impression to permit a finding of "willfulness" (much less a "willful refusal"). *Id.*

- The Initial Decision also erred in finding that Respondents "willfully refused" to comply with the Section 106 requests despite the fact that the Division had invoked Section 106(f), which allows Respondents to satisfy document production obligations by producing workpapers to the CSRC. *Id.* at 98-100.

- The Initial Decision erred in ignoring unequivocal evidence that the CSRC has produced to the SEC several of the audit workpapers at issue (and is on the verge of producing others)—despite acknowledging such evidence as "potentially exculpatory." *Id.* at 110. This evidence goes to the very core of this case and disposes of the entire proceeding against Respondents.

- The ALJ erred in applying Section 106 in several instances where Respondents did not issue audit reports, a prerequisite for Section 106 to apply. Order on Mots. For Summ. Disp. as to Certain Threshold Issues at 11.

- The ALJ further erred in permitting the proceeding to move forward when the Orders Instituting Proceedings ("OIPs") were not effectively served on Respondents. *Id.* at 11.

- The Initial Decision erroneously concluded that Respondents should be censured and suspended from practice for six months. Initial Decision at 109. That sanction is arbitrary and capricious, disproportionate, and (as the Division itself has acknowledged)

contrary to the public interest. It also rests upon a misapplication of the *Steadman* factors and the incorrect legal conclusion that a partial bar is not permitted under Rule 102(e).[1]

These novel and critically important questions of law and policy require Commission review. Certainly, the suspension of all the major audit firms from the world's second largest economy—with its attendant implications for U.S. foreign policy, financial reporting, and both U.S. and international capital markets—should not take effect contrary to the will of Congress and the relevant statutory provisions, on an admittedly incomplete factual record, and without careful review by the Commission. Respondents therefore respectfully request that the Commission grant this petition for review, and ultimately overturn the Initial Decision.

ARGUMENT

I. THE INITIAL DECISION ERRED IN CONSTRUING SECTION 106'S "WILLFUL REFUSAL" STANDARD AND FINDING THAT IT HAS BEEN SATISFIED HERE

A. The Initial Decision Adopted an Erroneous Construction of Section 106's "Willful Refusal" Standard.

The Commission must review and reverse the Initial Decision because it adopts an erroneous construction of the "willful refusal" standard set forth Section 106(e). The "willful refusal" standard applies to hundreds of foreign accounting firms, and its proper construction represents the central legal question in this proceeding. The Initial Decision reflects the very first time any court or tribunal has construed this critical provision in Section 106. Indeed, a week into the hearing, the ALJ said that the interpretation of "willful refusal" remained "wide open." Tr. 1228:13-22. Ultimately, the Initial Decision concluded that "willful refusal to

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[1] Additionally, Respondents currently have a motion pending before the ALJ that seeks reversal of his decision that Respondents and their relevant personnel cannot view the sealed version of the Initial Decision. Permitting access for these persons is critical to Respondents' ability to participate fully in their defense, and is consistent with the access previously ordered by the ALJ for reviewing confidential information. The Division has indicated it does not oppose providing Respondents and their relevant personnel with access to the sealed Initial Decision. To the extent the ALJ does not grant such access, Respondents intend to seek review of that decision on review by the Commission.

comply" means merely "'choosing not to act after receiving notice that action was requested,' *without regard to good faith*." Initial Decision at 88 (emphasis added). That interpretation is wrong as a matter of law. The Initial Decision strains to avoid the clear import of the nearly unique statutory language used in Section 106(e), and does not give proper weight to the statute's structure and history, as well as the principle of prescriptive comity. The Commission should not allow this erroneous holding on such an important legal issue of first impression to stand. The term "willful refusal to comply" requires proof of lack of good faith or conscious wrongdoing—a standard the Division did not (and cannot) meet here.

Section 106(e) provides that only a "*willful refusal* to comply" with an SEC request for audit workpapers or other documentation constitutes a violation of SOX or the Securities Exchange Act of 1934. 15 U.S.C. § 7216(e) (emphasis added); *see* Initial Decision at 88-90. The term "willful refusal to comply" is a rare and exacting formulation in the U.S. Code that evidences Congress's intent to require a heightened level of culpability for violations of Section 106. Numerous statutes use the word "willful," and others impose consequences upon a "refusal" alone. But in Section 106(e), Congress paired those terms: "willful," a state of mind, and "refusal," an act that already entails knowing and intentional conduct. Consistent with basic canons of statutory construction, the combination of those terms—and each of them—must be given meaning. *See Astoria Fed. Sav. & Loan Ass'n v. Solimino*, 501 U.S. 104, 112 (1991). If Congress had intended Section 106(e) to reach every knowing failure to produce documents (as the ALJ concluded), Congress could have omitted the word "willful" (because a mere "refusal to comply" is, by definition, a knowing and voluntary act), or used the term "willful failure" instead (in which "willful" is paired with an act that can be satisfied through mere inadvertence or inability). Thus, the plain language of Section 106(e) demonstrates that Congress intended the

"willful refusal" standard to require proof of more than just conscious conduct; it requires a heightened level of culpability.

The Initial Decision's construction ignores the language of Section 106(e) and renders key statutory language superfluous. The Initial Decision attempts to escape this result by relying on a PCAOB decision construing a different statutory provision altogether (*i.e.*, Section 105). Initial Decision at 89 (discussing *R.E. Bassie & Co.*, PCAOB File No. 105-2009-001 (Oct. 6, 2010)). But the PCAOB's construction of the term "refusal" in Section 105 (which does not apply to the SEC) sheds no light on the *Congressional* intent behind adopting the "willful refusal" standard in Section 106 (which does). Indeed, Congress authorized the PCAOB in Section 105 to pursue noncooperation charges against any accounting firm (foreign or domestic) that "refuses to ... produce documents," 15 U.S.C. § 7215(b)(3), and did not provide that such conduct constitutes a violation of the federal securities laws. In the very next section (i.e., Section 106), however, Congress utilized the very different "willful refusal" standard to define when a foreign accounting firm's noncompliance with SEC requests actually constitutes a violation of law. In any event, extrapolating from the *Bassie* decision, the Initial Decision ultimately takes the position that the words "refusal" and "failure" mean the same thing. Initial Decision at 89-93. But that approach is inconsistent with those words' ordinary meaning and the longstanding recognition by courts in the United States that the term "refusal" itself requires knowing and intentional action, and is distinct from a mere "failure," which does not. *See, e.g.*, *In re Jordan*, 521 F.3d 430, 434 (4th Cir. 2008) ("[T]he word 'refused' does in fact require the showing of a willful or intentional act, not merely the showing of a mistake or the inability to comply."). In the end, rather than give proper meaning to Section 106(e)'s rare statutory formulation, the Initial Decision simply ignores the actual language of the statute and changes

the operative legal standard in this case, specifically holding that "'willful *refusal*' ... is 'properly read as 'willful *failure*.'" Initial Decision at 94.

Furthermore, the Initial Decision's construction of "willful refusal" makes Section 106(e) superfluous in its entirety. Absent Section 106(e), any failure to produce documents would be a violation of the securities laws because 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 required under Section 106(b) would then 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) requires more, providing that only a "willful refusal" will be "deemed a violation." 15 U.S.C. § 7216(e). For Section 106(e) to serve any purpose at all, the term "willful refusal" must mean more than mere "willful" failure—it must require proof of lack of good faith.

The Initial Decision's construction of Section 106(e) flies in the face of the structure and legislative history of the Dodd-Frank amendments to SOX. Congress unmistakably was aware and respectful of possible conflicts of laws in this context. 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. *See e.g.*, Respondents Post-Hearing Brief at 11-13. Far from riding roughshod over foreign laws, as the Initial Decision unapologetically does here, Congress accommodated principles of comity by employing the heightened "willful refusal" standard.

Indeed, absent greater clarity from Congress, tenets of prescriptive comity *require* a construction of Section 106(e) that makes room for good faith compliance with foreign law. *F. Hoffmann-La Roche Ltd. v. Empagran, S.A.*, 542 U.S. 155, 164 (2004) (the principle of

prescriptive comity requires courts to construe statutes to "avoid unreasonable interference with the sovereign authority of other nations"). The Initial Decision, however, attempts to re-write Section 106's legislative history to support its erroneous construction. And it summarily concludes that its construction of Section 106 does not "unreasonabl[y] interefer[e]" with China's sovereign authority, while acknowledging that it could lead to the "inability of every single China-based issuer to trade on U.S. exchanges" and ignoring the fact that it requires Chinese firms to violate Chinese law on Chinese soil. Initial Decision at 96. Thus, the Initial Decision's construction of Section 106 finds no support in the plain language, structure, or statutory history of Section 106, nor in applicable principles of statutory construction.

Finally, even if the Initial Decision's construction of Section 106(e) were correct (which it is not), it would at least need to incorporate a good faith inability defense. A long line of authorities, including decisions 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 Initial Decision (erroneously) construes Section 106(e) to embrace. *See, e.g.*, *Société Internationale v. Rogers*, 357 U.S. 197, 212 (1958). The Initial Decision, however, quickly dismissed the relevance of this authority on the grounds that "[t]his proceeding is one to vindicate the Commission's right to regulate who practices before it, rather than one to compel production of documents," and thus "various civil discovery-related cases ... are inapposite." Initial Decision at 95-96. But this attempted distinction is facile and cannot diminish several decades of U.S. jurisprudence on foreign legal impediments to document production. Here, and throughout, the Initial Decision's conclusions are based on an unworkable Catch-22 that implicitly interprets "willful refusal" to be meaningless. Where it suits, the Initial Decision goes so far as to conclude that this case has

nothing to do with the production of documents by Respondents, in order for the Initial Decision to ignore the express terms of Section 106 and Supreme Court precedent that precludes finding a party did not produce documents "willfully" where foreign laws prohibit it.

Having thus misconstrued the operative legal standard, the ALJ's Initial Decision does not consider Respondents' good faith in assessing their liability under Section 106(e)'s "willful refusal" standard, and instead specifically holds that it is irrelevant. Initial Decision at 93, 103. Indeed, the Initial Decision found that Respondents "willfully refused" under Section 106 despite also holding that *it would have violated Chinese law* to produce the workpapers directly to the Staff.[2] And the Initial Decision completely ignores a series of other critical and indisputable facts from the hearing record that establish that Respondents acted in good faith and thus did not violate Section 106. *See* Respondents Post-Hearing Brief at 47-60; Respondents Post-Hearing Reply Brief at 34-36. The Initial Decision's observation about Respondents' good faith in the context of analyzing a completely distinct legal issue (*i.e.*, scienter under the *Steadman* factors) cannot substitute for a full analysis of good faith under Section 106(e). Initial Decision at 103-106. And in any event, those observations are inconsistent with well-settled law and Congressional intent.[3] No court has ever before found a lack of good faith in analogous

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[2] The ALJ Decision correctly found that Chinese oral law (or "neibu") prohibits the direct production of documents to the SEC. Initial Decision at 103-04. It also contains dicta concerning Chinese written law that is somewhat unclear. *See id.* at 103. To the extent the Initial Decision found that Chinese written law does not similarly prohibit Respondents from producing the requested documents directly to the SEC, that finding is clearly erroneous and should be reversed. Together, Article 179 of the Law of the People's Republic of China on Securities, Regulation 29, the State Archives Law, and the State Secrets Law clearly prohibit such direct production. Indeed, there was *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....").

[3] The fact that Respondents registered with the PCAOB and continued to perform services for U.S.-listed companies despite an awareness of the possibility of Chinese legal impediments is a legally insufficient basis for a finding of bad faith. A nearly identical factual scenario is present in every

circumstances, and such an approach would have far-ranging implications for foreign accounting firms around the world.

Accordingly, the Commission should review and carefully consider the proper interpretation of this important statutory provision, which can be satisfied only if Respondents acted in bad faith. Ultimately, it should reverse the Initial Decision because the Division cannot establish that Respondents acted in bad faith or engaged in conscious wrongdoing.

B. The Initial Decision Erred in Permitting the Division to Bypass Section 106's Judicial Enforcement Process and Otherwise Finding Enforceability "Irrelevant."

In his April 30, 2013 order addressing Respondents' threshold objections, the ALJ erred in permitting the Division to initiate this proceeding without first seeking judicial enforcement of the underlying Section 106 requests, as is required by both Section 106 itself and notions of due process. The Initial Decision takes this error a step further—holding that the enforceability of the Section 106 requests (which it concludes would require the violation of Chinese law) is entirely "irrelevant" and need not be considered by any tribunal—judicial or administrative. Initial Decision at 101. But without judicial review of the Section 106 requests—or *at least* an assessment of enforceability in this proceeding—there can be no finding of "willful refusal."

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single U.S. court decision involving foreign legal impediments, yet there are numerous cases—including the seminal, binding case from the D.C. Circuit (*In re Sealed Case*)—finding that foreign parties have acted in good faith under those circumstances. *See, e.g.*, *Société Internationale*, 357 U.S. at 212 (notwithstanding the fact that the Swiss bank had clearly "availed itself of business activities" in the United States (and even initiated the legal action), the Supreme Court found that it had acted in good faith); *In re Sealed Case*, 825 F.2d 494, 498-99 (D.C. Cir. 1987) (banks that conducted business in the United States acted in good faith).

1. The ALJ Erred In Permitting the Division to Bypass Judicial Enforcement of the Section 106 Requests.

The proceedings below should have been dismissed at the outset because they were initiated without the Division first complying with the judicial enforcement procedure set forth in Section 106. The Division itself has acknowledged that Section 106 requests are not self-enforcing, and that an action to "enforce" such requests must be brought in federal district court. *See, e.g.*, ENF Consolidated Opp. to Mots. for Summ. Disp. as to Certain Threshold Issues at 31. Congress's directive in Section 106(b)(1) is plain and unambiguous: only the "courts of the United States" have "jurisdiction ... for purposes of enforcement of any request" for the production of documents under Section 106. 15 U.S.C. § 7216(e). However, the ALJ held that the Division could bypass altogether judicial enforcement of the requests and proceed directly to sanctioning the Respondents through administrative proceedings under Rule 102(e). Order on Mots. for Summ. Disp. as to Certain Threshold Issues at 7 ("The Division is plainly not seeking to enforce the requests or obtain documents through these proceedings and therefore it is irrelevant whether such an enforcement action must be adjudicated by a federal court."); Initial Decision at 101. In doing so, the ALJ adopted a construction of Section 106 under which foreign accounting firms can be sanctioned for not complying with document requests that a federal district court might find unenforceable. *Id.* This is not what Congress intended in enacting Section 106.

Indeed, important constitutional considerations compel that Section 106 requests be enforced in federal court before sanctions are imposed. As in Section 106 Congress has required judicial enforcement of other investigative requests in order to preserve the separation of powers and in recognition that the enforcing agency is necessarily an interested party concerning the validity of its own requests. *United States v. Bell*, 564 F.2d 953, 959 (Temp. Emer. Ct. App.

1977) ("Bifurcation of power, on the one hand of the agency to issue subpoenas and on the other hand of the courts to enforce them" is required to eliminate any potential "abuse of subpoena power" that could result if an agency was authorized to enforce its own subpoenas.). Judicial enforcement also guarantees due process for the recipient of an investigative request. *See Donovan v. Lone Steer, Inc.*, 464 U.S. 408, 415 (1984) (a person served with an "administrative subpoena" must be afforded the "protection" to "question the reasonableness of the subpoena, before suffering any penalties for refusing to comply with it, by raising objections in an action in district court"). Further, the SEC's own forms and policies require that the SEC seek enforcement of a document request in federal court before instituting any disciplinary proceeding, and a departure from that process here is arbitrary and capricious and violates the Administrative Procedures Act. *See, e.g.*, Respondents' Mot. for Summ. Disp. at 19-21. By ignoring Section 106's judicial enforcement procedure, the Initial Decision stripped Respondents of important Constitutional and procedural protections.

2. The Initial Decision Erred in Finding That the Enforceability of the Section 106 Requests Is "Irrelevant."

Even if the Division could somehow, as a procedural matter, skip over *judicial* enforcement and initiate administrative proceedings against Respondents (and it cannot), the underlying enforceability of the requests must be determined *in this proceeding* before there can be a finding of "willful refusal." Indeed, 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. *See* Respondents Post-Hearing Brief at 63-75; Respondents Post-Hearing Reply Brief at 51-60. But the Initial Decision wrongly held that "[b]ecause judicial enforcement of the Sarbanes-Oxley requests is not a prerequisite to this proceeding, it is *irrelevant* whether the Sarbanes-Oxley 106

requests are enforceable." Initial Decision at 101 (emphasis added). That erroneous legal conclusion is inconsistent with Congressional intent, strips foreign accounting firms of important procedural safeguards, and renders considerations of international comity irrelevant.

The Initial Decision specifically concluded that the Section 106 requests would require Respondents (China-based audit firms) to violate Chinese law on Chinese soil, defy the direct orders of Chinese governmental entities, and subject themselves and their personnel to potentially severe sanctions. *Id.* at 103-104. Under well-settled law, 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). 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; (e) the importance to the litigation of the information and documents requested; and (f) the ability to obtain the subpoenaed information through alternative means." Restatement (Third) of Foreign Relations Law of the U.S. § 442(1)(c) (1987); *see also In re Westinghouse Elec. Corp. Uranium Contracts Litig.*, 563 F.2d 992, 997 (10th Cir. 1977); *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. Société 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"). In this case, the 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."). Holding that enforceability is "irrelevant," the Initial Decision does not address the comity analysis at all. Initial Decision at 101. That is clear error.

Proper consideration of these factors demonstrates that the Section 106 requests are unenforceable, Respondents have no legal obligation to comply with them, and thus there can be no finding of "willful refusal." Indeed, each of the relevant factors undercuts the enforceability of the requests: (1) the CSRC is clearly an alternate means to obtain the workpapers; (2) China's interest in ensuring that Chinese companies comply with Chinese law outweighs the SEC's limited interest in *direct* productions; (3) Respondents face severe sanctions if they violate Chinese law; (4) the Staff's own actions belie the purported "importance of the documents" to their investigations; and (5) it is undisputed that Respondents and the requested documents reside entirely within mainland China. *See* Respondents Post-Hearing Brief at 63-75; Respondents Post-Hearing Reply Brief at 51-60.

Ultimately, in the absence of a definitive determination of enforceability (which, under Section 106, must be made by a federal court), the dynamic is just two parties contesting their respective rights and obligations—not a "willful refusal to comply." The Commission should review and reverse the Initial Decision's determination that judicial enforcement was not required, and more generally that the enforceability of the Section 106 requests is "irrelevant" in this proceeding.

C. The Initial Decision's Conclusion that Respondents' Legal Obligations Were Objectively Certain—And Therefore Permitted a Finding of "Willfulness"—Is Erroneous.

Commission review is also required because the Initial Decision's holding that Respondents "willfully refused" under Section 106 is inconsistent with the U.S. Supreme Court's holding in *Safeco Ins. Co. of Am. v. Burr*, 551 U.S. 47 (2007). In that case, the Court made clear that a party does not "willfully" violate a statute (much less engage in a "willful refusal") 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. *Id.* at 69-70 & n.20.

In the instant case of first impression, Respondents' legal obligations could not have been more uncertain, and their conduct was certainly, at minimum, based on an "objectively reasonable" view of the law. *See* Respondents Post-Hearing Brief at 76-90; Respondents Post-Hearing Reply Brief at 60-63. Indeed, no tribunal has ever determined whether the Section 106 requests are enforceable or require Respondents to violate Chinese law on Chinese soil. The operative legal standards shifted over time—from SOX to Dodd-Frank—without any judicial interpretation or authoritative guidance from the Commission. The term "willful refusal" is an extremely rare formulation in the U.S. code and no court or agency has ever engaged in any significant analysis of its meaning. The Initial Decision itself found that the statutory language is "not plain." Initial Decision at 90. Further, it is not clear that Respondents are required to produce workpapers directly to the SEC when the CSRC has already produced them, or is in the process of doing so. At bottom, it is simply not clear that Respondents are obligated to violate Chinese law in order to comply with Section 106. Without more clarity, Respondents cannot be held to have acted "willfully" (much less to have "willfully refused") by adopting an "objectively reasonable" view of Section 106.

The Initial Decision rejects this argument in five sentences and with extremely little analysis. *Id.* at 101. First, the Initial Decision states that *Safeco* "pertains to the use of 'willfully' in a different context," but offers no explanation why or how the "different context" matters. *Id.* Indeed, it does not: *Safeco* considers the usage of "willfulness" in a statute that establishes civil liability, and holds generally that legal uncertainty prohibits the finding of such "willfulness." Second, the Initial Decision summarily concludes there is "nothing objectively unclear" about the statute and that Respondents "knew exactly what was expected from them." *Id.* But the Initial Decision's own extended grappling with the meaning of Section 106 belies that terse conclusion. *See also* Tr. 1228:13-22 (Judge Elliot noting, a week into the hearing, that the interpretation of "willful refusal" was "wide open").

Because Respondents' actions were thus based on an objectively reasonable understanding of the strictures of Section 106 during the operative time period, a finding of "willfulness" (or the heightened "willful refusal" standard) is prohibited by *Safeco*.

D. The Initial Decision Erroneously Held that Respondents "Willfully Refused" Despite the Staff's Invocation of Section 106(f).

The Initial Decision also erred because a finding that Respondents "willfully refused" to comply with the Section 106 requests is precluded by the Division's invocation of Section 106(f)'s "alternate means" provision. Initial Decision at 98-100. 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 first 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 worked and the documents have been produced. Having (successfully) invoked Section 106(f) in these two instances, the Staff cannot now punish DTTC for not producing the requested documents directly to the SEC.

Nor can the Division sanction the other firms because it is relying on the PCAOB to obtain the workpapers or deliberately chose not to seek their workpapers from the CSRC under Section 106(f) until after the hearing. 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 and when. In any event, prior to the Initial Decision, the Division and PCAOB *did* pursue alternate means and request from the CSRC all but two sets of the workpapers at issue here, and they are now on the verge of production to the SEC. The Division certainly cannot reverse course when it has so recently requested documents from the CSRC and while the CSRC is actively working to produce them to the SEC. For this independent reason, the Division cannot establish a "willful refusal" here.

The Initial Decision wrongly held to the contrary, and concluded that the Division's invocation of Section 106(f) places no constraints on the Commission's ability to punish Respondents and the "alternative means" of production through the CSRC "is inadequate as a matter of law." Initial Decision at 98-100. As discussed *infra*, that holding relies upon (1) a misreading of a Commission decision concerning a completely different issue;[4] and (2) the view that the CSRC is not "an adequate means for obtaining documents," which is inconsistent with the record, and particularly the evidence that the ALJ declined to consider. For this independent

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[4] *See In the Matter of the Application of Dagong Global Credit Rating Co.*, Exchange Act Rel. No. 62968, 2010 WL 3696139 (Sept. 22, 2010).

reason, the Commission should review and reverse the Initial Decision's conclusion that Respondents violated Section 106.

II. THE INITIAL DECISION IGNORES CRITICAL EVIDENCE OF THE CSRC'S RECENT PRODUCTIONS OF AUDIT WORKPAPERS AND SUBSTANTIAL COOPERATION WITH THE SEC

The Initial Decision must be reviewed and overturned because—by its own admission—it has ignored "potentially exculpatory" evidence that goes to the very core of this proceeding, and instead bases its conclusions on factual predicates that are false. Initial Decision at 110. Prior to the Initial Decision, the CSRC produced to the SEC DTTC's Client A and Client G workpapers and related documents as well as EYHM's Client C workpapers and related documents. *See* Respondents' Motion for Leave to Adduce Additional Evidence Pursuant to Commission Rule of Practice 452. These productions encompass the entirety of the DTTC workpapers at issue here, and all of the workpapers that the SEC had requested from the CSRC prior to the start of the hearing. *Id.* In addition, substantial progress has been made with respect to the production to the SEC of the remainder of the audit workpapers at issue here. Indeed, workpapers related to Client B (EYHM), Clients D and F (KPMG Huazhen), and Client I (PwC Shanghai) have all been produced to the CSRC and are in the process of being made available to the SEC and/or PCAOB.[5] *Id.* It is quite possible that the CSRC has actually produced additional workpapers to the SEC—a fact the Division is in the best position to confirm. The ALJ, however, rejected Respondents' efforts to supplement the hearing record with unmistakable evidence of these productions and substantial progress.[6] Initial Decision at 110. The refusal to

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[5] The SEC has never requested the CSRC's assistance in obtaining audit workpapers related to Client H (PwC Shanghai) or Client E (KPMG Huazhen).

[6] The ALJ could have and should have considered such evidence after the close of the scheduled hearing but before issuance of the Initial Decision. *See* Commission Rule of Practice 320 ("the hearing officer may receive relevant evidence"). Indeed, ALJ's have frequently admitted evidence in

consider this evidence—and the finding of a "willful refusal" and imposition of severe sanctions in the face of it—constitutes reversible error. Indeed, it infects every facet of the Initial Decision.

By not considering this critical evidence, the Initial Decision fails to acknowledge that the "production obligations" under Section 106 concerning the DTTC Client A, Client G, and EYHM Client C workpapers have been satisfied. Here, the Staff invoked Section 106(f) and pursued such "alternate means" by requesting the audit workpapers from the CSRC, and that process worked: the Division has received the DTTC Client A, Client G and Client C workpapers from the CSRC. The Section 106(f) alternative has been successful here, and thus the obligations under Section 106 concerning the requested materials have been satisfied. That alone is dispositive. In addition, the failure to consider evidence of the CSRC's multiple productions of workpapers to the SEC completely undermines the Initial Decision's analysis of Respondents' good faith and proves that Respondents were right to expect that a regulator-to-regulator solution would make production of the workpapers possible. *See supra* Section I.A. Similarly, the CSRC's productions make clear the CSRC is an effective "alternate means" by which the SEC can obtain the workpapers—as a result of which, the Section 106 requests at issue in this proceeding are unenforceable in the first instance. *See supra* Sections I.B.2, I.D.

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such circumstances in recognition that "[t]he Commission has made clear that it favors a liberal standard of admissibility." *See In the Matter of ALJ's Initial Decision Ernst & Young LLP*, 82 SEC Docket 2472, 2004 WL 824099, at *1-2 (Apr. 16, 2004) (granting motions to supplement the record filed by both Respondent and by the Division, after post-hearing briefing had been completed, and admitting documents into evidence); *see also In the Matter of Ted Harold Westerfield*, 66 SEC Docket 1616, 1998 WL 49459, at *1 (Feb. 9, 1998) (exhibit "offered and accepted into evidence by [ALJ] post-trial"); *In the Matter of George Salloum*, 53 SEC Docket 115, 1992 WL 409853, at *1 (Dec. 10, 1992) ("respondent was permitted to file a supplemental post-hearing brief based upon the Division's introduction of several new exhibits into the record"); *In the Matter of Combellick, Reynolds & Russell, Inc.*, 49 SEC Docket 247, 1991 WL 286760, at *1 (June 19, 1991) ("respondents, with permission, filed a supplemental post-hearing brief, as well as several post-hearing exhibits"). Here, the ALJ admitted over six hundred exhibits into the record, but declined to admit this critical evidence that he characterized as "potentially exculpatory."

This unambiguous and dispositive evidence should have been introduced into the record by the ALJ, and his refusal to do so resulted in a number of erroneous legal and factual findings that must now be reversed. And perhaps more fundamentally, by ignoring this evidence, the ALJ failed to acknowledge that the diplomatic dispute that triggered this proceeding has been resolved, and so the entire *raison d'être* of this proceeding has been eliminated. As the SEC itself has repeatedly acknowledged, [redacted] The ALJ should have considered this evidence, and given proper effect to the extremely substantial recent developments in this matter.

In rejecting Respondents' efforts to supplement the hearing record with this evidence, the ALJ held that the Respondents should, pursuant to Rule of Practice 452, seek leave to adduce the additional evidence upon review by the Commission. Initial Decision at 110. The Respondents have filed such a motion concurrently with this petition for review. This critical evidence must be admitted into the record and considered carefully by the Commission in assessing the Initial Decision. With such evidence properly admitted into the record, any holding that Respondents violated Section 106 (and any attendant sanction) cannot stand.

III. THE ALJ ERRED IN REJECTING RESPONDENTS' ADDITIONAL THRESHOLD CHALLENGES TO THE PROCEEDING BELOW

The ALJ also erred in rejecting two additional threshold objections on which Respondents moved for summary adjudication prior to the hearing. Specifically, the ALJ erred (1) in applying Section 106 to several instances where Respondents did not issue audit reports, a prerequisite for Section 106 to apply; and (2) permitting the proceeding to move forward when the OIPs were not effectively served on Respondents. The ALJ's holdings on these threshold

issues—which were incorporated into the Initial Decision—embody prejudicial errors of law and also constitute "decision[s] of law or policy that [are] important...." *See* Commission Rules of Practice 411(b)(2)(ii)(C), 411(e)(2).

First, Section 106 is not applicable in several instances here because Respondents did not issue audit reports, a prerequisite for Section 106 to apply. Section 106(a) provides that "[a]ny foreign public accounting firm *that prepares or furnishes an audit report with respect to any issuer* ... shall be subject to this Act...." 15 U.S.C. 7216(a) (emphasis added). Section 106(b) then sets forth a foreign accounting firm's obligation to produce audit workpapers under certain circumstances. In numerous instances, however, Respondents here did not "prepare[] or furnish[] an audit report with respect to an[] issuer," but, before doing so, instead noisily resigned or were terminated. *Id.* Indeed, the Initial Decision specifically acknowledges that the Respondents did not prepare or furnish audit reports for Client B (EYHM), Client E (KPMG Huazhen), Client G (DTTC), or Clients H and I (PwC Shanghai). Initial Decision at 11, 23, 33, 41, 43. The proceedings below therefore should have been dismissed as to the Section 106 requests for workpapers related to these clients because the threshold requirements set forth in Section 106(a) are not satisfied. *See* Respondent PwC Shanghai's Mot. for Summ. Disp. as to Certain Threshold Issues and Mem. in Support. The ALJ, however, erroneously concluded that Section 106(a) imposes no prerequisites for Section 106(b) and effectively can be ignored. Order on Mots. For Summ. Disp. as to Certain Threshold Issues at 10-15. This legal conclusion erroneously ignores the statutory framework and purpose, and must be reviewed and reversed by the Commission.

Second, the Commission did not properly serve copies of the OIPs on any of the Respondents. *See* Respondents' Mot. for Summ. Disp. at 9-11. Instead, the Commission

purported to serve Respondents' respective U.S. member firms as designated agents of Respondents. But in accordance with the plain language of Section 106, Respondents have designated their U.S. member firms for service of process *only* with respect to (a) the Section 106 requests themselves and (b) actions to enforce them (which here the Division has disclaimed as the purpose of this proceeding). There is no provision in the statute for designation of agents for service of an OIP, and no such designation has been made.

The Division has therefore asserted that the basis for serving the U.S. member firms was the "reasonably calculated to give notice" provision of Commission Rule of Practice 141(a)(2)(iv). But the problem for the Division is that the "reasonably calculated" provision and the OIPs themselves go on to say that such service is authorized only so long as it is "not prohibited by the law of the foreign country." Rule 141(a)(2)(iv). Here, the China Law of Civil Procedure establishes mandatory and exclusive service procedures under the Hague Convention on the Service Abroad of Judicial and Extrajudicial Documents ("Hague Service Convention"). *See* Respondents' Mot. for Summ. Disp. at 10-11. These procedures prohibit the SEC's attempted service of Respondents' U.S. member firms, and therefore service on them is improper here. After initially expressing concern about service of the OIPs, the ALJ ultimately punted on the issue, concluding that "the Commission directed that service of the OIP[s] be effected in [this] particular way," and that the ALJ "lack[ed] the authority to determine whether such an express directive violates the Commission's Rules of Practice." Order on Mots. For Summ. Disp. as to Certain Threshold Issues at 5. Certainly, the Commission lacks no such authority and should review the substance of Respondents' challenge to the manner in which the OIPs were purportedly served.

IV. THE INITIAL DECISION'S IMPOSITION OF A TOTAL SIX-MONTH PRACTICE BAR WARRANTS COMMISSION REVIEW

As set forth above, the Initial Decision's conclusion that Respondents violated Section 106 warrants review by the full Commission. Independently of the liability issue, the sanctions imposed in the Initial Decision also merit Commission review.

A. The Sanctions Imposed by the Initial Decision Raise Important Public Policy Issues That Should Be Reviewed and Decided by the Full Commission.

It is difficult to overstate the importance of the consequences that would flow from the sanctions imposed in the Initial Decision. Respondents are among the very largest accounting firms in mainland China. They are responsible for the vast majority of the audit work performed by PCAOB-registered Chinese firms for issuers with securities registered in the U.S. *See* Initial Decision at 78. [redacted] And they performed component audits (*i.e.*, performed less than 50 percent of the total audit work) for hundreds of other issuers, including many prominent U.S. multinationals with operations in China. As the Division recognized by choosing *not* to seek a complete bar, barring Respondents completely from performing audit work would likely create chaos for hundreds of issuers by disrupting the existing audit arrangements of both "China-based" and "U.S.-based" companies alike. *See, e.g.*, ENF Pre-Hearing Brief at 67 (proposing partial bar so "most large multinational issuers would remain able to procure auditing services from Respondents for China-based operations").

The Initial Decision imposed a severe and unjust sanction that barred the bulk of the auditing profession of an entire country from practicing before the Commission in any capacity for six months, which exceeded in this respect the scope of the remedy requested by the

Division. As a result, hundreds of issuers—including large U.S. multinationals with operations in China—now face the potential of being delisted or having non-compliant filings unless they are able to find new auditors to perform work critical to annual audits and quarterly reviews and who are somehow able to produce documents directly to the SEC without violating Chinese law and directives (which they cannot). As discussed below, the Initial Decision's imposition of a full practice bar rested on significant legal and factual errors. It also relied on the erroneous policy judgment that the benefits of sanctions outweighed their negative consequences. *See* Initial Decision at 106 ("the need to protect future investors outweighs the need to protect current investors"); *id.* at 107 (collateral consequences no "barrier to imposition of practice bar"). Regardless of whether the sanctions imposed by the Initial Decision were appropriate—and they were not—this case implicates not only the interests of the Commission and Respondents, but of hundreds of companies and their investors. In a case with such far-reaching effects, the decision to impose such severe and unprecedented sanctions should be reviewed by the Commission. In fact, the "most significant harm" that the Division identified as justifying its proposed sanctions—the harm caused by "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—does not exist in half of the investigations at issue in this case and cannot be said to have been caused by PwC Shanghai, who issued no audit opinions with respect to the clients at issue in this proceeding, or by EYHM, KPMG Huazhen, or DTTC with respect to Clients B, E, and G, for whom they issued no audit opinions.

The Initial Decision's imposition of sanctions also departed from long-standing Commission policies and practices. For decades, the Commission's policy has been to resolve foreign legal impediments to obtaining documents from foreign countries through inter-

governmental cooperation. The Initial Decision is the first time the SEC has ever sought to resolve such an impediment by barring audit firms that were prohibited by foreign law from producing documents directly to the SEC, *see* Initial Decision at 103-04, from practicing before the Commission. The Initial Decision's imposition of sanctions thus effectively reverses a decade-long program under which scores of accounting firms from countries with strict data privacy, official secret or similar laws (including Respondents) were authorized by the PCAOB and SEC to serve as auditors for SEC registrants, despite being legally prohibited from producing documents directly to the SEC. For decades, the SEC has allowed foreign firms located in such countries to serve as auditors, relying on government–to-government cooperation to obtain information and to regulate those firms. Here, just months after the CSRC finalized its protocols and began making productions of audit workpapers to U.S. regulators under such a government-to-government process, the Initial Decision seeks to impose an unprecedented and draconian punishment on all of the major accounting firms in China. *See id.* at 52, 110; *see also* Respondents' Supp. Motion (November 20, 2013). Although an agency can change long-established policy under certain circumstances, *see, e.g.*, *FCC v. Fox Television Stations, Inc.*, 556 U.S. 502, 515 (2009), doing so requires the Commission itself to take several steps and should not be subordinated to the ALJ here.

Finally, the Initial Decision's imposition of sanctions threatens to disrupt the Commission's ongoing relationship with the CSRC and to derail the new processes by which documents (including some of the very workpapers at issue in this case) have already begun to flow to the SEC and PCAOB.[7] Indeed, the ALJ expressed concern that "some of [its] factual

[7] The PCAOB, faced with identical issues related to access to workpapers in China, has continued to pursue diplomatic means with success. Respondents Exs. 273, 277, 632A, 650A; *see also* Leung Tr. 1479:9-12 (explaining that EYHM received a request regarding Client C from the PCAOB through the

findings and legal discussion may interfere with any ongoing discussions between the Commission and the CSRC" and, accordingly, redacted large portions of the Initial Decision. *See* Initial Decision at 4. But the chilling effect on SEC-CSRC relations caused by the *text* of the Initial Decision is likely to be trivial compared to that caused by the *fact* that the Initial Decision sanctions Respondents for failing to take actions that would have violated Chinese law and the specific directions of the CSRC. *See id.* at 103-04.

B. The Initial Decision's Sanctions Analysis Rests on Clearly Erroneous Findings of Fact and Conclusions of Law That Should Be Reviewed by the Full Commission.

1. The Initial Decision Erred In Concluding that Sanctions Would Serve 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, *6 (Feb. 28, 1981) (dismissing proceedings). Simply put, 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).

In deciding to impose sanctions, the Commission must also exercise "reasoned decisionmaking." *Allentown Mack Sales & Serv., Inc. v. NLRB*, 522 U.S. 359, 374-75 (1998). As the D.C. Circuit noted in *Steadman v. SEC*, mechanically applying the six factors set forth in that case is insufficient. 603 F.2d 1126, 1140 (5th Cir. 1979), *aff'd on other grounds*, 450 U.S. 91 (1981). Instead, the Commission must give reasoned consideration to all important aspects of

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CSRC); 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).

the problem that the sanctions are meant to address. *See, e.g.*, *Saad v. SEC*, 718 F.3d 904, 913-14 (D.C. Cir. 2013). It must, for example, consider and give appropriate weight to relevant mitigating factors raised by a respondent, including the collateral impact sanctions would have on the respondent and on third parties, such as investors. *See, e.g.*, *PAZ Sec., Inc. v. SEC*, 494 F.3d 1059, 1065 (D.C. Cir. 2007).

The Initial Decision imposed a "total" six-month bar without giving *any* consideration to the collateral impact such a bar would have on issuers and their investors.[8] In so doing, it utterly failed to engage in the "reasoned decisionmaking" that is required under the Administrative Procedure Act. Instead, the ALJ erroneously concluded that he could disregard the impact of his decision on third parties (such as issuers and their investors) because "[c]ollateral consequences to existing investors are not *the* determining factor in evaluating sanctions in the public interest." Initial Decision at 106 (emphasis added). But the D.C. Circuit has made crystal clear that collateral consequences are *a* factor that must be considered and given weight. *See PAZ*, 494 F.3d at 1065; *Saad*, 718 F.3d at 913-14. Indeed, 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*, 494 F.3d at

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[8] The ALJ rejected the Division's proposed partial bar, in critical part, because he concluded that "it is not clear" that Rule 102(e) permitted such bars and that there was no precedent for imposing one. *See* Initial Decision at 109. In a series of cases stretching back four decades, however, the Commission has repeatedly imposed less-than-total bars and suspensions on auditors under Rule 102(e) (and its predecessor, Rule 2(e)). *See, e.g.*, *In the Matter of Ernst & Young LLP*, Initial Decision Rel. No. 249 (April 16, 2004) (suspension of one office of respondent under Rule 102(e) from accepting audit engagements for new audit clients for six months, but allowing respondent to continue to audit existing clients); *Ernst & Whinney and Michael L. Ferrante, C.P.A.*, SEC Initial Decision Rel. No. 3-6579 (June 28, 1990) (bar under Rule 2(e) from accepting new audit engagements for 45 days, but allowing respondent to continue to audit existing clients); *In the Matter of Ernst & Ernst, Clarence T. Isensee and John F. Maurer*, Securities Exchange Act Rel. No. 3-2233 (May 31, 1978) (bar under Rule 2(e) from practicing before the Commission with respect to new clients for six months); *In the Matter of Peat, Marwick, Mitchell & Co.*, Exchange Act Rel. No. 3-4695 (July 2, 1975) (bar under Rule 2(e) from accepting new audit engagements for six months, but allowing respondent to continue to audit existing clients).

1065; *Steadman*, 603 F.2d at 1139. The Initial Decision made no effort to engage in this analysis.

Moreover, the Initial Decision imposed a "total" six-month bar in the complete *absence* of evidence of what the collateral consequences of such a bar would be. The Division had requested only a "partial" bar; and therefore, the parties did not present any evidence regarding the effects of a more severe "total" six-month bar.[9] Thus, the ALJ had before him only evidence of the effects of a "partial" bar. Admittedly, the Initial Decision dismissed Respondents' evidence of the natural consequences of a partial bar as "unpersuasive" or "irrelevant," Initial Decision at 108-09, by speculating that firms *not registered* with the PCAOB might be able to take over Respondents' work in China, *see id.* at 106-07,[10] and that those firms might not be prohibited under Chinese law from producing workpapers, *id.* at 107-08 (even though Respondents were prohibited from doing so, *id.* at 103-04). The Initial Decision's rejection of this evidence is not only erroneous, it also inappropriately placed on Respondents the burden of proving that the sanctions were not justified (rather than requiring the Division to show that they were), contrary to *PAZ*, 494 F.3d. at 1065; *Steadman*, 603 F.2d at 1139; and *In*

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[9] Indeed, because the Division limited the scope of the bar it sought, Respondents chose not to call witnesses they had placed on their witness list. Respondents' Consolidated Witness List (June 14, 2013). Neither the Division nor the ALJ ever suggested that a complete bar was a possibility, thus denying Respondents the opportunity for a full and fair hearing on that issue. Indeed, both the Division and Respondents focused their evidence, arguments, and briefing on the likely collateral impacts of a partial bar. For example, Respondents presented evidence of the number of issuers that would be required to change auditors if the partial bar were imposed, and the losses that investors would likely suffer if those issuers were unable to find replacement auditors and were forced to delist. Respondents' expert calculated that the losses to investors could exceed $200 billion. Initial Decision at 82. [redacted]

[10] The ALJ also gave no apparent weight to the suitability of these "adequate substitutes," despite noting in a footnote that at least one of the firms named in the Initial Decision had been recently sanctioned for failing to comply with PCAOB standards, engaging in improper professional conduct, and causing a client to commit disclosure and reporting violations. *See* Initial Decision at 23, n. 4.

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). In the end, the Initial Decision had no justification for its unprecedented sanction; it did not consider the collateral consequences of such a sweeping order; and the ALJ admittedly had no evidence regarding the "total" six-month bar imposed.

2. The Initial Decision Erred In Applying the *Steadman* Factors.

In concluding that a total six-month practice bar was warranted, the Initial Decision purported to evaluate the public interest factors identified in *Steadman*. Initial Decision at 102-03. The inquiry into these public interest factors is "flexible ... [with] no one factor [being] dispositive." *Peak Wealth Opportunities, LLC*, Exchange Act Rel. No. 69036, Investment Company Act Rel. No. 30414, 2013 SEC LEXIS 664, at *22 (ALJ Mar. 5, 2013). Yet, the Initial Decision's imposition of sanctions was based largely on just two factors. The Initial Decision placed "considerable weight" on what it identified as Respondents' "fail[ure] to recognize the wrongful nature of their conduct ... [and] opportunities for future violations." Initial Decision at 103. The weight given to these two factors is misplaced.

Respondents' recognition of the "wrongful nature of their conduct" is inapplicable in this situation because Respondents were bound by foreign legal impediments. The question whether one's action was "wrongful" necessitates that there was an alternative "right" action. Respondents did not have the luxury of such a choice. Indeed, even the Initial Decision recognized that Respondents were given an oral directive not to produce their audit workpapers, and that Respondents were under the threat of "draconian Chinese law." *Id.* at 103, 106. Yet, the Initial Decision incorrectly discounted this legal impediment by laying the blame largely at the feet of Respondents. *Id.* at 105. The Initial Decision found that—even though they were abiding by the law of their home country and had followed the registration process established by the SEC and PCAOB—Respondents had placed "themselves between a rock and a hard

place," and that their actions in response to the Commission's investigations "demonstrated gall" and not good faith. *Id.* As discussed *supra*, the Initial Decision's conclusion that Respondents did not act in good faith is legally unsupportable. It is also factually incorrect, as it ignores that Respondents did all they could to facilitate a regulator-to-regulator production. And it ignores the fact that Respondents were transparent about the potential Chinese legal impediments to producing documents directly to U.S. regulators, that they are similarly situated to hundreds of foreign accounting firms around the world, and that both Respondents and the U.S. regulators assumed there would be a diplomatic solution.

Additionally, contrary to the Initial Decision's assertion, Respondents almost certainly will not have opportunities for future violations. The Initial Decision concluded that "future violations are virtually certain." *Id.* at 103. That conclusion, however, incorrectly disregards the fact that the CSRC is now a viable avenue to obtain audit workpapers—both evidence that was presented at the hearing, *see* Respondents Exs. 455, 631A; George Tr. 1635:11-1636:5, and improperly excluded after the hearing, *see* Initial Decision at 110. This available alternative to production is precisely why Congress included Section 106(f) in the Dodd-Frank amendments to SOX. 15 U.S.C. § 7216(f). The Initial Decision misses the point; far from being "oblivious," Initial Decision at 103, Respondents reasonably believe based on recent productions that they will be able to respond to future requests under the information-sharing protocols agreed to by Chinese and U.S. regulators.

As discussed *supra*, the Initial Decision incorrectly construes Section 106(f) and concludes that the "alternative means" of production through the CSRC "is inadequate as a matter of law." *Id.* at 99. The Initial Decision's conclusion of law relies on an incorrect application of *Dagong Global Credit Rating Co.*, Securities Exchange Act Rel. No. 62968 (Sept.

22, 2010). *Dagong* involved the Commission's denial, under a separate statutory scheme, of the application of a Chinese credit agency due to doubts that the applicant could comply with document production and similar obligations by producing through the CSRC. Initial Decision at 99-100. The Initial Decision's reliance on *Dagong* is erroneous. It ignores the fact that there is no Section 106(f) equivalent for credit rating agencies, and ignores the Congressional intent underlying the Dodd-Frank amendment. *See* S. Rep. 111-176, at 152-53 (2010). And the statute under which the application in *Dagong* was denied specifically provides for a sanction if the registrant is "unable to comply" with federal securities laws, in stark contrast to the language chosen by Congress for Section 106.

C. The Initial Decision is Arbitrary and Capricious, Disproportionate, and Contrary to the Public Interest.

The Commission should review the Initial Decision because the imposition of the total six-month bar is arbitrary and capricious, disproportionate, and counterproductive. As noted above, the sanctions in this case are inconsistent with the Commission's longstanding policy of resolving foreign legal impediments to obtaining information and documents through negotiation of bilateral and multilateral cooperative agreements with foreign counterparts. The departure from this past practice, particularly in light of the significant progress made with the CSRC, is impermissibly arbitrary and capricious. The Initial Decision, without acknowledging the departure, justifies the approach by concluding the Commission can "use one avenue rather than another" to obtain documents. Initial Decision at 100. This justification is insufficient, as "an agency changing its course must supply a reasoned analysis indicating the prior polices and standards are being deliberately changed." *Greater Bos. Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970).

Additionally, the total six-month bar is wholly disproportionate. Any sanction imposed must be proportionate to the conduct at issue. *See Chambers v. NASCO, Inc.*, 501 U.S. 32, 40 n. 5 (1991). A total six-month practice bar is far in excess of what is mandated when the public interest factors are properly considered. Indeed, Respondents did not act with scienter, the alleged violations were not egregious, the alleged violations were not recurrent, and there is no evidence in the record indicating Respondents' conduct harmed investors. Initial Decision at 103, 106, 109.[11] To the contrary, the evidence showed that Respondents identified potential financial statement errors, thoroughly investigated and demanded audit evidence, and resigned or refused to render an opinion where satisfactory evidence was not provided. In fact, the Division's witnesses admitted that it was Respondents' work that often helped the Division initiate its investigations and resulted in several of the companies at issue being delisted after the auditors' resignation. In short, it was Respondents' thorough work and integrity which identified the potential inaccurate financials, and Respondents vigorously worked to investigate those issues. Those are not facts which justify barring Respondents from practice.

Lastly, the total six-month bar is contrary to the public interest. The sanction removes the most qualified members of the auditing profession from an entire country,[12] is punitive in nature, and appears to have been imposed because Respondents were deemed to be "oblivious" to the nature of their conduct and to the risk of future violations, and demonstrated

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[11] The other factors are either inapplicable—*i.e.*, recognition of wrongfulness, and opportunities for future violations—or are not sufficient to warrant a total six-month bar—*i.e.*, age of violation, deterrent effect of sanctions.

[12] The Initial Decision also presumes that the CSRC has tacitly permitted other auditors to produce documents directly to the SEC, and therefore the public interest somehow can be protected by the use of those auditors. Initial Decision at 107. But this speculation has no basis whatsoever in the evidence presented. If one concludes that such speculation is, in fact, wrong, then there is no alternative and the public interest is at significant risk. Issues of such importance to the global economy should not turn on the Initial Decision's incorrect guesswork.

"gall" in their response to the Commission investigation. *Id.* at 103, 105. And it does not address the challenge of obtaining workpapers from China. Sanctions that have no remedial effect, but would instead merely punish, are impermissible.

CONCLUSION

Based on the foregoing, the Commission should grant Respondents' petition for review of the Initial Decision, which contains erroneous conclusions of law and fact on an issue of vital public importance. Based upon review of the original record and additional evidence, Respondents respectfully submit that the Commission should reverse the Initial Decision.

Dated: February 12, 2014

Respectfully submitted,

(*Signatures on next page*)

Dated: February 12, 2014

Respectfully submitted,

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