UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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

In the Matter of BDO China Dahua CPA Co., Ltd.; Ernst & Young Hua Ming LLP; KPMG Huazhen (Special General Partnership); Deloitte Touche Tohmatsu Certified Public Accountants Ltd.; PricewaterhouseCoopers Zhong Tian CPAs Limited, Respondents.	The Honorable Cameron Elliot, Administrative Law Judge

RESPONDENT PWC SHANGHAI'S REPLY IN FURTHER SUPPORT OF ITS MOTION FOR SUMMARY DISPOSITION AS TO CERTAIN THRESHOLD ISSUES

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Respondent PwC Shanghai respectfully submits this reply in further support of its motion for summary disposition as to certain threshold issues and dismissal of the OIP.[1]

PRELIMINARY STATEMENT

The Division's opposition fails to establish that Section 106 applies to PwC Shanghai in this instance. The Division concedes that PwC Shanghai never prepared or furnished any audit reports with respect to Client H or Client I. (See Opp.[2] at 25 & n.14.) And the Division does not dispute that the SEC's and PCAOB's own statements have repeatedly confirmed that the purpose of a Section 106(b) request is to ensure the reliability of audit reports. (See PwC Shanghai Br. at 14-15.) Indeed, the Division continues to assert that it needs the documents it requested pursuant to Section 106(b) "to conduct ongoing investigations and to supervise accounting professionals . . . whose work is *incorporated into Commission filings and relied upon by U.S. investors*." (Opp. at 2 (emphasis supplied).) The Division's attempt to defend its position by pointing to other "Sarbanes-Oxley[] policies" that might justify a Section 106(b) request even in the absence of an audit opinion is unavailing. (See Opp. at 27-30.) None of those policies is implicated in the investigations of Client H and Client I, one of which the SEC settled before the OIP was even issued.[3] In fact, the Division's entire opposition is an *after-the-fact* exercise in trying to avoid

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[1] The defined terms used herein have the same meaning as they do in Respondent PwC Shanghai's Motion for Summary Disposition as to Certain Threshold Issues and Memorandum in Support ("PwC Shanghai Br."). Consistent with prior efforts to consolidate arguments to the fullest extent practicable and to avoid duplicative submissions, Respondents Ernst & Young Hua Ming LLP ("EYHM"), KPMG Huazhen (Special General Partnership), and DTTC join in this reply with respect to Clients B, E, and G. As indicated in the separate reply brief being filed today by DTTC, PwC Shanghai, along with all other Respondents, joins in the separate independent arguments made by DTTC therein in support of its motion for summary disposition as to certain threshold issues.

[2] "Opp." refers to the Division of Enforcement's Consolidated Opposition to Respondents' Motions for Summary Disposition as to Certain Threshold Issues.

[3] Although the OIP states that "[t]he Division of Enforcement has ongoing fraud investigations concerning Clients A, B, C, D, E, F, G, H, and I" (OIP ¶ 6), public filings confirm that the Commission accepted Client I's offer of settlement before the OIP was issued. Counsel for PwC Shanghai is happy to provide the Hearing Officer with references to those filings on a confidential basis in order to maintain the confidentiality of the identity of Client I.

the natural reading of Section 106(a) as an issuer-specific threshold for application of Section 106(b)'s production requirements. Nowhere in the OIP did the Division even reference Section 106(a), much less explain how PwC Shanghai could somehow have satisfied it without preparing or furnishing any audit reports for Client H or Client I. (See Opp. at 25-26.) The strained interpretations of Sections 106(a) and 106(b) that the Division now offers not only fail to address the issues raised by PwC Shanghai, they create additional statutory construction problems.

ARGUMENT

I. SECTION 106 DOES NOT APPLY IN THIS INSTANCE AND THEREFORE CANNOT FORM THE BASIS OF THE OIP

A. PwC Shanghai's Interpretation of Section 106(a) as a Gatekeeping Provision Does Not Read Section 106(b)'s "Triggering Conditions" out of the Statute

The Division's primary argument is that PwC Shanghai's construction of Section 106(a) as requiring that a foreign public accounting firm prepare or furnish an audit report for an issuer before Section 106(b)'s production obligations may be imposed would read Section 106(b)'s "triggering conditions" out of the statute and would render meaningless the Dodd-Frank amendment to Section 106(b). (See Opp. at 20-22.) The Division is incorrect. PwC Shanghai's construction gives meaning to the Dodd-Frank amendment to Section 106(b). It does not, however, accept that that amendment also worked to repeal *sub silentio* the general applicability requirement set forth in Section 106(a).

In addition, PwC Shanghai understands that the SEC settled its investigation of Client B in October 2012 and that Client B was ordered to cease and desist from further violations and its registration of securities was revoked. PwC Shanghai further understands that counsel for EYHM is happy to provide the Hearing Officer with information related to the SEC's settlement with Client B in a confidential manner.

Unlike after the Dodd-Frank amendment, prior to it, Section 106(b) required a foreign firm to *issue* an audit report.[4] See Pub. L. No. 107-204 (Opp. Attach. 4), § 106(b)(1). Post-Dodd-Frank, Section 106(b) was expanded to cover circumstances beyond where the foreign firm actually issues the audit report to situations in which it performs audit work or conducts interim reviews. See 15 U.S.C. § 7216(b)(1). In other words, now, provided the applicability trigger of Section 106(a) is met and Section 106(b) is applicable, it is satisfied not only when the foreign firm issues an audit report, but also when it performs audit work or conducts interim reviews. In this way, Dodd-Frank did expand the scope of Section 106(b).[5] PwC Shanghai has thus "account[ed] for the nature of the amendment." (Opp. at 21.)

None of that, however, impacts Section 106(a), which remained unchanged post the Dodd-Frank amendment. That applicability requirement, which by its plain terms requires the preparing or furnishing of an audit report, remained in full force and effect post Dodd-Frank. That, in and of itself, is dispositive of the construction question, but in any event the Division's position rests on a flawed, unspoken and wholly unsupported assumption. Specifically, the problem with the Division's central argument is that it assumes, without support or analysis and contrary to the plain language of the statute, that "preparing" or "furnishing" an audit report is the same thing as (or necessarily includes) performing audit work or conducting interim reviews. The fact that Congress used different words in subsection (a) (i.e., "prepares" or "furnishes") as

[4] Both before and after Dodd-Frank, Section 106(b) covered situations where a foreign firm "performs material services upon which a registered public accounting firm relies." Pub. L. No. 107-204, § 106(b)(1); 15 U.S.C. § 7216(b)(1). That provision is not at issue here with respect to Client H or Client I.

[5] Of course, the main way in which Dodd-Frank expanded the scope of Section 106(b) was by changing the production requirement—when it applies—from just "audit workpapers" to "audit work papers . . . *and all other documents* of the firm related to any such audit work or interim review." Pub. L. No. 107-204, § 106(b)(1); 15 U.S.C. § 7216(b)(1) (emphasis supplied). The Division ignores this change in its strained attempt to argue that the only way to give effect to the Dodd-Frank amendment is to interpret Section 106(b)'s production obligation as being triggered by the mere performance of audit work or the conduct of an interim review.

compared to subsection (b) ("issues" an audit report, "performs" audit work, or "conducts interim reviews") necessarily means, however, that they describe different activities. See, e.g., Corley v. United States, 556 U.S. 303, 315 (2009) ("[T]here is . . . every reason to believe that Congress used . . . distinct terms very deliberately."); Russello v. United States, 464 U.S. 16, 23 (1983) ("We refrain from concluding here that the differing language in the two subsections has the same meaning in each. We would not presume to ascribe this difference to a simple mistake in draftsmanship."). Indeed, Section 106(b), itself, reflects the fact that issuing an audit report is distinct from, and does not necessarily include doing, audit work. See 15 U.S.C. § 7216(b)(2) (recognizing that an accounting firm may "rel[y], in whole . . ., on the work of [another] accounting firm in issuing an audit report"). Likewise, preparing an audit report or furnishing it simply means getting it ready or giving it to someone. The term "furnish" is oft-used in the securities law and is well-recognized to mean turning something over. It is often contrasted with filing. See, e.g., 17 C.F.R. § 240.13a-16(c) ("Reports furnished pursuant to this rule shall not be deemed to be 'filed'. . . ."). "Prepare" simply means "to make ready," Webster's Third New Int'l Dictionary 1790 (1993); Black's Law Dictionary 1182 (6th ed. 1990), and, just as with "issue," is not the same as doing the underlying audit work.

B. The Division's Reading of Section 106(b) Would Render Subsection 106(b)(2) Unnecessary

PwC Shanghai's reading of Sections 106(a) and 106(b) gives meaning to both subsections of Section 106(b), while the Division's interpretation would render subsection (b)(2) unnecessary. Subsection (b)(2) requires a "registered public accounting firm that relies, in whole or in part, on the work of a foreign public accounting firm" to "produce the audit work papers of the foreign public accounting firm." 15 U.S.C. § 7216(b)(2).

Under PwC Shanghai's construction, subsections 106(b)(1) and (b)(2) serve distinct functions. Subsection (b)(1)'s production obligation is only applicable where a foreign firm prepares or furnishes an audit report, such that Section 106(a)'s threshold requirement is satisfied. (See PwC Shanghai Br. at 9-12.) Subsection (b)(2), by contrast, applies where a foreign firm has *not* prepared or furnished an audit report: in this circumstance, the SEC may seek, through subsection (b)(2), production of the foreign firm's work papers from a registered firm that relies on the work of the foreign firm.

Under the Division's construction, however, subsection 106(b)(2) is superfluous. Because the Division interprets subsection (b)(1) as applying even where a foreign firm does not prepare or furnish an audit report (see Opp. at 20), the SEC *never* needs to request documents from the registered firm pursuant to subsection (b)(2); it can simply obtain documents directly from the foreign firm pursuant to subsection (b)(1). Moreover, subsection (b)(2)(B) calls for a registered firm that relies on the work of a foreign firm to secure a consensual agreement of the foreign firm to produce work papers and other materials. See 15 U.S.C. § 7216(b)(2)(B). Again, under the Division's interpretation of the statute, the foreign firm would already be obligated to produce such materials under subsection (b)(1), even if Section 106(a) were not satisfied. If so, there would have been no reason for Congress to create a mechanism to obtain a consensual agreement to obtain that which the very same subsection, under the Division's construction, already requires by force of law. Indeed, the Division's reading violates the "cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant." TRW Inc. v. Andrews, 534 U.S. 19, 31 (2001) (internal quotation marks omitted).

C. The Division's Construction of Section 106(a) as Relating Solely to the Circumstances and Manner in Which Foreign Public Accounting Firms are Subject to SOX *as Registered Entities* Is Untenable

The Division's argument that Section 106(a) does not serve a gatekeeping function, but rather relates solely to the "circumstances and manner" in which foreign firms are subject to SOX as "registered entities" (Opp. at 23), ignores both the text and statutory context of Section 106(a). As the Division acknowledges, "[t]o read out of a statutory provision a clause setting forth a specific condition or trigger to the provision's applicability is . . . an entirely unacceptable method of construing statutes." (Id. at 20 (quoting Natural Resources Defense Council, Inc. v. EPA, 822 F.2d 104, 113 (D.C. Cir. 1987).) Yet that is exactly what the Division seeks to do.

The Division cannot dispute that Section 106(a)'s gatekeeping function is announced in its title: "Applicability to certain foreign firms." (See PwC Shanghai Br. at 10.) Indeed, the Division concedes, as it must, that Section 106(a) "addresses the particular applicability of [SOX] to foreign firms." (Opp. at 23.) The Division also concedes, as it must, that Section 106 is part of SOX. (See, e.g., id. at 6.) From these two concessions, it inevitably follows that Section 106(a) addresses the applicability of *all of Section 106*—including Section 106(b)—to foreign firms. Yet the Division nonetheless argues that "[n]othing in Section 106(a) suggests that it provides a 'threshold' test for applying the other subsections of Section 106." (Id. at 23.) Under this logic, subsection 106(b) is somehow not within SOX, even though Section 106, as a whole, is. This is, of course, wholly inexplicable.[6]

[6] The Division's argument that Section 106 does not move from a general statement of applicability in subsection (a) to the enumeration of specific obligations found in subsection (b) because subsections (c) and (g) are "every bit as 'general'" as subsection (a) is also misguided. (Opp. at 23.) First, Section 106(g) is purely definitional. Its placement at the end of Section 106 is consistent with other provisions of SOX that move from the general to the specific and its location has no significance to the overall structure of the Section. See, e.g., 15 U.S.C. § 7232; 15 U.S.C. § 7264. Second, Section 106(c) was, prior to Dodd-Frank, the penultimate section of Section 106. See Public L. No. 107-204, § 106. This too, is wholly consistent with PwC Shanghai's account of Section 106's structure: (1) it begins by specifying the scope of its applicability in 106(a); (2) it then specifies specific obligations that may then be triggered under 106(b); and then (3) specifies agency action that could eliminate

Flaws in the Division's interpretation of Section 106(a) are further illustrated by Section 106(f), notwithstanding the Division's assertion that "Section 106's other subsections" support its position. (Opp. at 23.) Section 106(f) authorizes the Commission to "allow a foreign public accounting firm *that is subject to this section* to meet *production obligations under this section* through alternate means." 15 U.S.C. § 7216(f) (emphasis supplied). If the italicized portions of this provision are both to have meaning, they cannot *both* refer to Section 106(b). See 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."). Instead, it is clear that a foreign firm is "subject to" Section 106 when it has satisfied 106(a) by preparing or furnishing an audit report with respect to a particular U.S. issuer. (See PwC Shanghai Brief at 9-12.) Only once that requirement has been met can the firm *also* have "production obligations under" Section 106, *i.e.*, pursuant to 106(b). The Division's attempt to sever Section 106(a) from the rest of Section 106 is thus fundamentally irreconcilable with the plain language of Section 106(f). Moreover, Section 106(f) was added as part of the 2010 Dodd-Frank amendments, exposing the defective logic underlying the Division's claim that, "[e]ven assuming Section 106(a) had the gatekeeping function asserted by Respondents when that provision was enacted in 2002 . . . such a function no longer can exist in light of Dodd-Frank." (Opp. at 22 n.11.) Section 106(a) was not somehow "implicitly amended" as the Division suggests. (Id.) It continues to serve the same gatekeeping function that it always has. (See PwC Shanghai Brief at 12.)

The Division's attempt to sever Section 106(a)'s applicability test from the production obligation of Section 106(b) is also directly at odds with the presumption against construing statutes to apply extraterritorially. See Morrison v. Nat'l Australia Bank, 130 S. Ct. 2869,

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specific obligations pursuant to 106(c). It thus makes perfect sense that Section 106(c) would follow the obligations delineated in Section106(b).

2877-78 (2010); (PwC Shanghai Br. at 11). Under the Division's interpretation, the SEC can demand documents from an unregistered foreign public accounting firm that conducts a limited interim review for a client, even where all of the work takes place abroad, no resulting audit report is prepared or furnished, and the foreign auditor produces no work on which investors in U.S. markets could rely. (See Opp. at 20, 22.) Moreover, as this proceeding makes clear, the Division believes that noncompliance with such a demand is sanctionable, even if the noncompliance is required by the laws of the country where the auditor is located and all the work occurs. The Division's expansive construction thus violates the principle that "Congress ordinarily legislates with respect to domestic, not foreign matters." Morrison, 130 S. Ct. at 2877. That principle is even stronger where, as here, a finding of extraterritorial application would pose a significant risk of conflict with foreign law. See id. at 2885 (recognizing the "probability of incompatibility with the applicable laws of other countries" in rejecting extraterritorial application); EEOC v. Arabian Am. Oil Co., 499 U.S. 244, 248 (1991) (explaining that the presumption against extraterritoriality "serves to protect against unintended clashes between our laws and those of other nations which could result in international discord"). PwC Shanghai's interpretation of Section 106, which limits production obligations to foreign firms that have actually prepared or furnished an audit report for a U.S. issuer—thereby directly impacting investors in U.S. markets—is mandated by Morrison.

D. The Division's Reading of Section 106 Unduly Strains the Statutory Text and Fails to Provide the Necessary Predicate

The Division asserts in its opposition brief—though it did not do so in the OIP—that Section 106(a)'s applicability test has been met because PwC Shanghai has prepared or furnished audit reports for other U.S. issuers, never mind that those other issuers have no connection

whatsoever with the engagements for Client H and Client I at issue here.[7] (See Opp. at 24-27.) As PwC Shanghai explained in its opening brief, however, interpreting Section 106(a) to be satisfied for *all* audit clients for all time as soon as a foreign public accounting firm prepares or furnishes a single audit report as to *any* issuer creates the same problem as interpreting Section 106(b) to be independent of Section 106(a)—namely, that Section 106(b) lacks the requisite nexus to the United States. (See PwC Shanghai Br. at 9 n.4, 11.)

Confronted with the fact that untethering the obligations of Section 106(b) from Section 106(a)'s issuer-specific gatekeeping function would impose burdens on foreign firms without the necessary predicate, the Division tries to argue—again, after the fact—that Section 106(b)'s use of the word "audit" ensures the necessary U.S. nexus, because "audit" is defined elsewhere in SOX as relating to U.S. issuers. (See Opp. at 23-24, 27.) But the Division is mistaken for at least four reasons:

First, as the Division concedes, the term "interim review," which is also used in Section 106(b), is not defined in SOX. (See Opp. at 24 n.12.) Thus, under the Division's construction, a foreign public accounting firm could be required under Section 106(b) to produce work papers associated with interim reviews for a private foreign client with absolutely no ties to the United States.[8] Such a reading of the statute must "be avoided" because it produces absurd results and

[7] In the alternative, the Division argues that Section 106(a)'s applicability test has been met either because PwC Shanghai may have "played a substantial role in reports" for other issuers, or because PwC Shanghai's registration with the PCAOB subjects it to "oversight by the Board and the Commission." (Opp. at 26.) Neither of these implausible theories is sufficient to render PwC Shanghai subject to Section 106(b)'s production obligation in the absence of a jurisdictional predicate. That predicate is lacking from the Division's construction of Section 106 for the reasons described *infra*.

[8] The Division's contention that "it is clear from the context that the provision relates to an interim review of an issuer, since the Commission can only request workpapers from foreign firms relating to audits of U.S. issuers" (Opp. at 24 n.12) finds no support in the statute's text.

contravenes the presumption against extraterritorial application of the securities laws. Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 575 (1982); see also Morrison, 130 S. Ct. at 2877-78.

Second, if Congress wanted Section 106(b) to be a standalone obligation limited to U.S. issuers, it presumably would have placed such a limitation explicitly within the subsection, rather than burying the necessary U.S. nexus in the definition of "audit" elsewhere in SOX, especially since, as noted above, whatever jurisdictional limitation is conferred by the definition of "audit" does not apply to Section 106(b)'s use of the term "interim review."

Third, if, as the Division contends, the necessary U.S. nexus exists by virtue of "audit" being defined to relate to U.S. issuers, then the phrase "with respect to any issuer" is surplusage in Section 106(a)(1)'s use of the phrase "audit report with respect to any issuer," because "audit report" is also defined to relate to U.S. issuers. See 15 U.S.C. § 7201(4). The Division's reading thus violates the fundamental principle of statutory construction that words should not be construed to be superfluous. See TRW, 534 U.S. at 31.

Fourth, the definition of "issuer" contained in the Securities Exchange Act of 1934 and referenced as the base definition within SOX Section 2(7) is not limited to U.S. issuers. See 15 U.S.C. § 78c(a)(8); 15 U.S.C. § 7201(7). That is indeed the natural and plain reading of "issuer," as it is commonly understood that there are "issuers" all around the world. Thus, it is not at all clear that the U.S. registration prongs contained in Section 2(7) are intended to alter within SOX the commonly understood definition of "issuers," which includes both U.S. and non-U.S. issuers. Indeed, Section 2(7) seems to accept the more expansive securities laws definition of "issuer." Moreover, Section 2(7)'s definition is of "*an* issuer" and includes the additional limitations of an issuer with certain types of accounts. In contrast, Section 2(2), which defines "audit," employs

the phrase "*any* issuer," further suggesting the more expansive reading.[9] See 15 U.S.C. § 7201(2).

In sum, the only coherent way to read Section 106(b) so that it contains the necessary predicate, and does not violate the strong presumption against extraterritorial application of the securities laws, is to construe Section 106(a) as establishing an issuer-specific threshold that must be satisfied before Section 106(b)'s burdens may be imposed.[10]

E. To the Extent that the Dodd-Frank Amendment Did Not Accomplish What the Division Claims that Congress Wanted, It Is for Congress, and Not this Tribunal, to Fix

According to the Division, PwC Shanghai "ignore[s] Congress's deliberate decision in 2010 to amend Section 106(b)" and provides "no explanation as to how that amendment could have any meaning." (Opp. at 21.) As set forth above, that is simply untrue. PwC Shanghai has explained precisely the additional powers that the Division gained as a result of Dodd-Frank's changes to Section 106. To the extent this expanded authority still falls short of what the Division believes it should possess, it should pursue that goal legislatively, not through this proceeding. See Richards v. United States, 369 U.S. 1, 10 (1962) ("[W]e are bound to operate

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[9] The Division's arguments about the definition of an "audit" also say nothing about the phrase "audit work," which is the applicable phrase used in Section 106(b). In any event, the Division's arguments are, more fundamentally, of no moment to the question of whether Section 106(a) is, as it itself indicates, an applicability trigger for Section 106(b). The convoluted construction of the definition of "audit" employed by the Division to read into Section 106(b) a U.S. nexus, which more naturally flows out of Section 106(a), makes little sense. PwC Shanghai made the point in its opening brief that, divorced from Section 106(a), Section 106(b) could apply to foreign firms' work for foreign clients with no U.S. connections. (See PwC Shanghai Br. at 11.) It is not surprising, given Morrison and its progeny, that the Division feels constrained not to accept such an expansive reading of Section 106, but its construction gymnastics to find safe ground are not only unpersuasive, they essentially ignore the natural construction of Section 106(a).

[10] Under PwC Shanghai's construction, Section 106(a)'s issuer-specific threshold also provides the necessary predicate for Section 106(d)(2). The Division's interpretation of Section 106(d)(2), like its construction of (b)(1), as applying to foreign public accounting firms in the absence of an audit report for a U.S. issuer (see Opp. at 23) is likewise strained.

within the framework of the words chosen by Congress and not to question the wisdom of the latter in the process of construction.").

CONCLUSION

For the foregoing reasons, and those set forth in PwC Shanghai's opening brief, the Hearing Officer should dismiss the OIP.

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