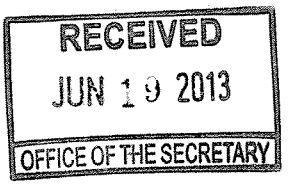
UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION

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.; and
PricewaterhouseCoopers Zhong Tian CPAs Limited,

Respondents.

The Honorable Cameron Elliot,
Administrative Law Judge

DIVISION OF ENFORCEMENT'S RESPONSE TO RESPONDENTS' MOTION TO QUASH THE DIVISION'S REQUEST FOR THE ISSUANCE OF SUBPOENAS DIRECTED AT RESPONDENTS

The Division of Enforcement ("Division") of the U.S. Securities and Exchange Commission ("SEC" or "Commission") respectfully submits this Response in further support of its Request for the Issuance of Subpoenas Directed at Respondents (the "Request").

INTRODUCTION

Through the Request, the Division seeks highly relevant evidence that goes to the heart of Respondents' claimed defense in these proceedings: notwithstanding written Chinese law, which plainly did *not* require Respondents to seek approvals from the China Securities Regulatory Commission ("CSRC") before producing requested documents to the SEC, officials from the CSRC orally instructed Respondents to abstain from making such productions. The Division believes Respondents willfully violated the Sarbanes-Oxley Act (the "Act") – by willfully

refusing to comply with the SEC's requests under Section 106 of the Act ("Section 106 requests") – regardless of what the CSRC orally told Respondents. But now that a full Hearing will be held in which these factual issues are to be explored, the Division and this Court should have access to documents that describe, summarize, or memorialize these oral communications. Respondents' planned hearsay testimony about the oral statements of Chinese regulators (though unavailing in any event) should be supplemented by Respondents' written records of these alleged statements, to the extent any exist, and by any written correspondence between Respondents and the regulators.[1]

Respondents also should be ordered to produce the other, targeted categories of documents relevant to their alleged "good faith" in failing to comply with the Section 106 requests, and to potential remedies for their willful refusals, that are sought by the Request. Indeed, Respondents' unwillingness to produce even the most basic of information that should be at their fingertips – such as recent engagement letters and composite firm data about revenues and fees – wholly undermines the credibility of their claim the Division's proposed subpoena is burdensome.[2] The Request is narrow in scope, was timely filed in response to recent developments in these proceedings, and should be granted in full.

ARGUMENT

A. The Request Seeks Highly Relevant Documents

[1] Plainly, Respondents must provide their "Correspondences from Respondents to CSRC from October 12, 2011 to May 11, 2012," which their Chinese law expert Xin Tang states that he received from Respondents and reviewed in the preparation of his expert report. *See* Expert Report of Professor Xin Tang, Ex. 1, at page I (item 7.c on list) (filed Jun. 18, 2013) ("Tang Report"). To the extent Respondents have not already provided this information to the Division, they should do so immediately.

[2] Respondents' stonewalling stands in sharp contrast to the Division's agreement voluntarily and promptly to produce additional documents related to Respondents' Request for Subpoena, which the Court denied without prejudice on June 5, 2013. Within two days after the June 5 Order, the Division agreed to make an additional, voluntary production to Respondents. The Division then acted expeditiously and completed the additional production by June 13, 2013.

1. Good Faith

Respondents vigorously contend that if they demonstrate that they made good faith efforts to comply with the 106 requests, then they will not have willfully violated the Act. At the Second Pre-Hearing Conference, held May 29, 2013, counsel for each Respondent insisted on the need for an evidentiary hearing at which they could make this showing. Tr. of Second Prehearing Conference, at 10:3-14:18 (May 29, 2013). Given the obvious importance of the issue to Respondents, they cannot deny that the documents sought by Request items 1 through 4 are highly relevant.

Item 1: Documents constituting or reflecting communications between Respondents and the Chinese Government. These go to the heart of Respondents' argument that their refusals to comply with the Section 106 requests were not "willful." Respondents do not contest the relevance of these documents, nor could they. In claiming that Chinese regulators instructed them not to produce the requested documents to the SEC, Respondents have tried to rely on letters from the CSRC from October 2011 that allegedly provide this instruction. But even a cursory review of the letters demonstrates that no such instruction was given.[3] Thus Respondents will try to prove the alleged prohibition through testimony about meetings with the CSRC that same month, before the letters were issued. They may try to do this through no fewer than 11 of the 13 named witnesses who are employees of Respondents or their affiliates. *See* Respondents' Consolidated Witness List, ¶¶ 2-8, 12-15 (June 14, 2013 (listing potential testimony from 11 witnesses regarding "communications" or "interactions" with the Chinese

[3] One letter relied upon by Respondents states, for example, only that productions to overseas regulators must "comply with the relevant laws, regulations and requirements" of Chinese law, "and should follow the required legal procedures." Letter from CSRC to KPMG Huazhen, in translation provided by KPMG Huazhen (Oct. 17, 2011) (attached hereto as Exhibit 1). *See* Expert Report of Donald Clarke, at ¶ 43 (observing October 17, 2011 letter "simply instructs recipients to follow existing law, something they were already required to do") ("Clarke Report"); *id.* ¶ 69 (making similar observation as to CSRC's October 11, 2011 letter).

government). They will not provide any testimony from the CSRC. It is only appropriate that Respondents provide their documents summarizing, describing, or memorializing these conversations, so that their intended hearsay testimony (to the extent accepted at all by the Court) can be tested.

Item 2: Documents constituting or reflecting communications with Clients about U.S. requests for audit workpapers. Respondents contend that "Respondents' communications with [the] Clients are not relevant to any disputed issue," but such communications may bear directly on Respondents' claim of good faith by showing whether Respondents have consistently represented, both to private clients and to government entities, their inability to produce workpapers to the SEC or PCAOB. The documents may also reveal Respondents' attempts, or lack thereof, to confer with their Clients about whether the audit workpapers contain state secrets. Under Chinese law, it is the duty of entities producing state secrets (in this case the audited companies) to identify them as such with an appropriate classification and to mark them as well. *See* Clarke Report ¶ 20. Upon receipt of the Section 106 requests, if Respondents had doubts about whether the requested documents contain state secrets, they could have tried to reduce (or perhaps eliminate) such uncertainty by consulting with their Clients about the information the Clients transmitted to Respondents in the first place.[4] Their failure to do so would undermine their claim of good faith even further.

Item 3: Information about current clients, including engagement letters. This information should be easy for Respondents to produce. Respondents' assertion that "much of the information sought by Request 3" is available through public filings ignores the fact that

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[4] Certain Clients provided documents to the SEC, casting further doubt on the idea that Respondents' workpapers derived from those documents contain state secrets. *See* Clarke Report ¶ 22 ("[I]f materials transmitted from the audit company to the auditor do not contain state secrets, then presumptively the work papers generated by the auditor should not contain state secrets, either.").

wide swaths of this information – including so-called "substantial role" and "referral work" – are not so available, at least for four of the five Respondents.[5] Although the Division has received related data that the Respondents earlier produced to the PCAOB, this data was only through March 2012. As Respondents acknowledge, they are currently preparing information for the year-end March 2013 period to include in updated Form 2s due at the end of June. If the June 7 cut-off date presents particular complications, the Division will accept data (for all types of engagements included in the Request item) through March 2013.

The requested information is relevant to Respondents' continued, purposeful availment of U.S. markets, which informs the willfulness of their past refusals to comply with the Section 106 requests at issue. The information is also relevant to remedies, as likely it will help analyze the potential impact of a proposed bar on appearing or practicing before the Commission.

Item 4: Transmission of audit workpapers to principal auditors. Respondents object to this request because it "does not even relate to the *type* of work that the majority of Respondents performed for the Clients." Mot. to Quash at 10 (emphasis in original). But KPMG Huazhen performed only substantial role or referred work for Clients D, E, and F, so the requested materials are quite relevant as to that Respondent's liability. In any event, the requested documents go directly to all Respondents' claim of good faith. If such communications show that Respondents have transmitted audit workpapers outside of Mainland China – even to Hong Kong[6] – this undermines their assertions that production of the same types of documents to the SEC is prohibited because the documents are either state secrets or archives. *See* Clarke Report ¶ 38. It matters not at all whether these transmissions occurred for these Clients or other clients.

[5] Historically, only KPMG Huazhen has included these categories of information in its Form 2 annual reports.

[6] Hong Kong is the location of the principal auditor for each of KPMG Huazhen's engagements mentioned above.

The Division specifically limited this Request item to only the year-long period ending March 31, 2012 (not the longer period in the general instructions to the subpoena), to minimize burden. If Respondents nevertheless contend that it implicates a large volume of documents, the Division is willing to meet and confer on this item; it potentially might be resolved through an appropriate stipulation by Respondents.

2. Remedies

Items 5 and 6: Audit fee, revenue, and hour information. This information also should be easy for Respondents to generate, and they do not seriously contend otherwise. Respondents contend that because "neither monetary sanctions nor disgorgement is available in this proceeding . . . details regarding Respondents' fees and hours are not reasonably related to the question of whether Respondents should be barred from appearing or practicing before the Commission." Mot. to Quash at 10. But as noted above, in the Second Prehearing Conference counsel for Respondent DTTC argued that "remedies would require a hearing in this context where there's enormous impact on the capital markets, [and] there are issues of fairness with respect to these respondents." Second Prehearing Conference Tr., 13:5-9 (May 29, 2013). Moreover, Respondents' Consolidated Witness List includes three potential witnesses who may testify regarding the potential effects of any remedial measures ordered by this Court. *See* Respondents' Consolidated Witness List, at ¶¶ 16-18 (June 14, 2013). To the extent Respondents contend that "impact" on and "fairness" to Respondents are relevant to remedies, the Division should have access to the total, firm-wide categories of information sought by this Request item. As the Division explained during the parties' meet-and-confer, this information may help assess the effect of a proposed bar on appearing or practicing before the Commission

on Respondents' businesses, particularly alongside engagement-specific information that the Division might obtain.[7]

In item 6, directed only to Respondent Dahua, the Division seeks information that it already possesses with respect to Dahua's four co-Respondents. Like the information sought in Item 5, this data may help to measure the impact of a potential bar. Dahua has not objected to this item, and so there is no question that this Request item should be granted.

B. The Request Is Reasonably Targeted In Scope

Respondents complain that Items 1 and 2 seek materials pertaining not just to document requests from the SEC, but also to requests from the PCAOB. Mot. to Quash at 7. Such materials are relevant. Respondents have contended that the CSRC gave them instructions about audit workpapers not just in response to SEC requests, but also in response to PCAOB demands. These instructions were provided during approximately the same time period (October 2011). Because Respondents evidently regard both sets of instructions as bearing on whether they have permission to produce documents to the SEC under Chinese law, Respondents' documents constituting or reflecting communications with the CSRC about the PCAOB demands (Item 1) should be produced. Documents concerning communications with the Clients (Item 2) about PCAOB demands are relevant for the same reason.

Respondents twice complain that the Request would require them to "locate, review, and produce documents (many of which may be written in a foreign language) located overseas and in the possession of an indefinite number of employees." *Id.* at 2-3, 7. Respondents fail to

[7] A bar on appearing or practicing could take different forms. For example, it could consist of a complete bar against Respondents performing any audit work for issuers of securities traded in the U.S. Alternatively, it could consist of a partial bar, prohibiting only certain types of audit work, engagements with certain types of clients, or some combination thereof. In any event, both total, firm-wide information and engagement-specific information may help inform the analysis.

articulate how this description distinguishes the Request from any other discovery requests that could be directed to Respondents, which are foreign entities employing multiple employees located abroad who conduct business in languages other than English; their position thus appears to be that any discovery requests made of Respondents are inherently excessive. This cannot be the case.

Respondents complain, as well, that the Request is burdensome insofar as it would require them to document privileged materials. *See id.* at 7. However, during a telephonic Meet-and-Confer on June 12, the Division expressed a willingness to be flexible about the contents of any individualized privilege log, in light of the imminent hearing date.

Respondents' complaints about the potential breadth of the term "reflecting," *id.*, are similarly unavailing. Unlike Respondents' request for a subpoena, which the Court correctly denied, the Division's present Request does not use the broader term "referring." Moreover, for purposes of these proceedings, the Division is willing to construe the term "reflecting" to mean "summarizing, describing, or memorializing." This position also was communicated to Respondents during the June 12 Meet-and-Confer. Respondents, however, were unwilling to negotiate on this point.

C. The Division Filed the Request Promptly After The Second Prehearing Conference

The Division's Request, filed June 7, 2013 – nine days after the Second Prehearing Conference in which the hearing date was set – was not untimely. (During this same period, the Division produced additional documents in response to Respondents' own request.) As Respondents know, the Division has always maintained that these proceedings can – and should – be resolved on the papers, under the narrow definition of "willfulness" that the Commission and courts have consistently applied under the securities laws. Such a motion would not have

required the development of an extensive factual record, including the information that the Division now seeks through the Request. During the First Prehearing Conference, Respondents similarly indicated their belief that the case could be decided on the papers, even were the Court to deny (which it did) their motion for summary disposition on threshold issues. *See* First Prehearing Conference Tr., at 17:7-17:16 (Jan. 9, 2013) (Counsel for EYHM) ("[W]e essentially agree with the phasing that Mr. Mendel, I think, is talking about, and we may have summary disposition motions ourselves."). During the Second Prehearing Conference, held May 29, 2013, however, Respondents articulated their desire for a full live hearing, and so a hearing date was set. Promptly after circumstances changed, the Division filed its Request for Subpoena addressing the new (previously extraneous) factual issues that are likely to figure prominently during the hearing.

In no event could the Division have been expected to file its Request for Subpoena before April 30, 2013, the date of the Court's order denying Respondents' motions for summary disposition on threshold issues. During the First Prehearing Conference, the Court noted Respondents' claim that they were not properly served with the Orders Instituting Proceedings, and suggested it was possible that the timeframe for adjudicating the proceedings had not yet commenced. *See id.* at 8:2-16. Respondents' Motions for Summary Disposition, which addressed threshold issues including service, were filed February 1, and remained under consideration until April 30. Had Respondents prevailed on the issue of service, these entire proceedings would have been effectively stayed pending proper service. Any request for discovery prior to April 30 would therefore have been premature, and no doubt opposed by Respondents on that basis.

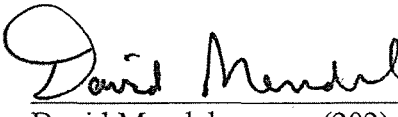
Nor should the Division be penalized for not seeking discovery earlier during the 38-day period between the April 30 Order and the date of its Request, June 7, 2013. On May 6, the Hearing Officer ordered a Second Prehearing Conference for May 29. During the subsequent weeks, Respondents and the Division reached agreement on a briefing schedule for the Division's planned motion for summary disposition as to liability. For the Division to seek discovery at that time, when the parties did not yet know whether a hearing on liability would even be ordered (much less when it would be ordered), again would have been premature and potentially wasteful. On May 29, when the Court declined to adopt the parties' proposed schedule or to permit the Division to file its intended Motion, the Division expeditiously crafted a targeted request for materials highly relevant to the newly-scheduled hearing.

CONCLUSION

As required under SEC Rule of Practice 232(b), the Division has demonstrated "the general relevance and reasonable scope" of the documents and information sought in the Subpoenas. For the reasons set forth above and in the Division's initial Request, the Division respectfully requests that the Hearing Officer issue the Subpoenas upon Respondents.

Dated: June 19, 2013

Respectfully submitted,



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COUNSEL FOR DIVISION OF ENFORCEMENT

EXHIBIT 1

[Letterhead of China Securities Regulatory Commission]

Accounting Department Letter No.[2011]422

CSRC's reply regarding certain audit firm's production of audit work papers overseas

To KPMG Huazhen,

We have received your letter "Regarding Client D and Client F Report and request for direction in respect of the further demand made by the US Public Company Accounting Oversight Board" issued on October 12, 2011. After deliberating and discussing with the Ministry of Finance, our reply is as follows:

With respect to the production of audit work papers and other materials overseas, audit firms should comply with the relevant laws, regulations and requirements of the PRC Securities Law, the PRC Certified Public Accountants Law, the PRC Law on Guarding State Secrets and the PRC Archives Law and should follow the required legal procedures, or otherwise bear any legal consequences.

Where overseas securities regulatory authorities would like to demand relevant audit work papers and other documents for the purpose of fulfilling their statutory duty, they should consult and agree with the PRC regulatory authority based on the audit oversight cooperation established with the authority.

Audit firms should properly handle the related matters in compliance with the applicable laws, regulations and requirements in the PRC. Any production of audit work papers and other documents overseas without appropriate permission in accordance with law shall be subject to legal liability.

October 17, 2011

中国证券监督管理委员会

会计部函〔2011〕422号

中国证监会关于部分会计师事务所向境外提供审计档案的复函

毕马威华振会计师事务所：

你所2011年10月12日《关于中国联合能源集团有限公司及山东盛大科技（集团）股份有限公司一美国监管机构对本所提出进一步要求的汇报和请示》收悉。经研究并商财政部，现回复如下：

会计师事务所对境外提供审计工作底稿等档案材料，应当符合《中华人民共和国证券法》、《中华人民共和国注册会计师法》、《中华人民共和国保守国家秘密法》、《中华人民共和国档案法》等有关法律法规及相关规定，并经过相应的法律程序，否则将依法承担法律后果。

境外证券监管机构履行其法定职责需要相关审计档案和其他文件的，应通过与中方监管机构的监管合作机制共

同协商解决。

会计师事务所必须遵守中国有关法律法规和相关规定，妥善处理好相关事宜；违反法律擅自向境外提供审计档案和其他文件的，依法追究其法律责任。

二〇二一年十月十九日