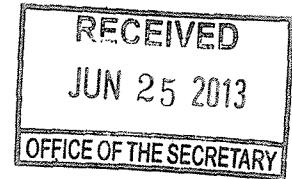


UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



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 ERNST & YOUNG HUA MING LLP'S PRE-HEARING BRIEF

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Respondent Ernst & Young Hua Ming LLP (“EYHM”) respectfully submits its Pre-Hearing Brief pursuant to Rule 222 of the U.S. Securities and Exchange Commission (the “SEC” or “Commission”) Rules of Practice, 17 C.F.R. Section 201.222, and the Court’s June 10, 2013 Order on Joint Motion to Amend Hearing and Prehearing Schedules.¹ EYHM also adopts, and incorporates herein, all applicable statements and arguments made in the Pre-Hearing Briefs submitted by Respondents Deloitte Touche Tohmatsu CPAs Ltd. (“DTTC”) and KPMG Huazhen (Special General Partnership) (“KPMG Huazhen”).

I. PRELIMINARY STATEMENT

By initiating this proceeding, the Division of Enforcement (the “Division”) has placed EYHM, along with the other Respondents, into the middle of its conflict with the China Securities Regulatory Commission (“CSRC”) regarding access to work papers prepared in China by China-based firms. But that is a dispute that can only be resolved by those regulators, not by seeking to sanction the Respondents for matters they cannot control. This ill-conceived effort to use the Respondents as leverage in the Commission’s negotiations with the CSRC fails because EYHM and the other Respondents have done everything in their power – short of committing serious violations of Chinese law that would threaten their existence – to comply with the Commission’s requests. As a result, and as the evidence at the hearing will establish, they have not “willfully refused” to produce documents and has not violated the federal securities laws.

Moreover, as the evidence at the hearing will also establish, no sanction could remedy the situation that led to the initiation of these proceedings – i.e., foreign law that prevents any audit firm, including but not limited to Respondents, from producing all the materials that the Division requested. Thus, under the circumstances of this case, any sanction would be purely punitive, not remedial, and therefore outside the Commission’s power to order.

¹ EYHM reserves all rights with respect to whether this action was properly served on EYHM as well as whether Section 106 is applicable to EYHM’s work for Client B, for which it never prepared, furnished or issued an audit report. Additionally, EYHM reserves all rights with respect to whether an enforceability determination by a federal court is a necessary precondition for the institution of this action.

As EYHM has repeatedly explained to the Division over the past two years, and as the Commission knows from its own extensive discussions with the relevant PRC regulators, EYHM simply cannot produce the documents requested by the Division in its two Section 106 Requests without, at the same time, subjecting itself to severe sanctions for violating Chinese law. In order to avoid exactly the dilemma in which it has now been placed, EYHM has consistently made good faith efforts to comply with the Division's requests without violating China law.

Starting from the time it received the Division's first voluntary request for the production of documents in June 2011, EYHM personnel, particularly Quality and Risk Management Leader of Greater China Alden Leung, have repeatedly met with representatives of the CSRC and the Chinese Ministry of Finance ("MOF") to explain the Division's requests and to seek ways to comply with them. As detailed below, and as will be demonstrated at the hearing, EYHM repeatedly sought authorization from those regulators to allow it to provide the SEC with materials it requested, including offering to produce the materials to the CSRC for its review and delivery to the SEC. However, EYHM was told on every such occasion that, consistent with China ("PRC") law, it could not produce the requested documents directly to the SEC. EYHM was further told that the SEC should make its requests to the CSRC. EYHM, in turn, explained those facts to the Division at length and in detail. It even provided the Division with a legal opinion from PRC counsel that exhaustively described the limitations imposed on it by PRC law, and forwarded a copy of the written instructions it received from the CSRC confirming its explanations. EYHM also produced whatever documents it could to the Division without subjecting itself to the potential of severe sanction in the PRC.

Although the Commission has determined to press forward with this proceeding, the testimony and evidence that EYHM will present at the hearing will demonstrate that it has not "willfully refused" to produce the requested materials and has not violated the federal securities laws, or Commission Rule 102(e).

II. BACKGROUND

A. Ernst & Young Hua Ming

EYHM is a special general partnership that is headquartered in Beijing and provides auditing and other professional services primarily to companies in the PRC. The firm also provides substantial assistance to other Ernst & Young member firms that issue audit reports on U.S. registrants.² EYHM was first established as a cooperative joint venture in Beijing in 1992, and has expanded significantly over the course of its twenty one year history. In 2004, the firm employed over 1,200 personnel, including nearly 1,050 accountants, 229 of whom had CPA or equivalent licenses, operating out of five offices. Ex. 1.³ Currently, EYHM has eight offices in mainland China and employs over 4,200 people, more than 3,700 of whom are accountants, and 998 of those accountants have CPA or equivalent licenses. Ex. 35. Even this dramatic growth does not fully capture the extent of EYHM's investment in its practice, training of its personnel, or the firm's commitment to developing a highly-skilled corps of professionals capable of meeting U.S. standards for accounting and auditing services.

Since it began its operations in 1992, EYHM has been registered with both the CSRC and the MOF, and is subject to the laws and regulations of the PRC. It is also a foreign public accounting firm in the United States, pursuant to Section 106 of the Sarbanes-Oxley Act, 15 U.S.C. § 7216 ("Section 106"). Between April 1, 2011 and March 31, 2012, EYHM issued audit reports for twenty one U.S.-issuers based in the PRC, and provided substantial assistance to EY member firms that issued audit reports on U.S. registrants in a substantial number of significant engagements. *Id.*

² EYHM is a member firm of EY Global Ltd. However, it is a separate and independent legal entity from all other members of EY Global. EYHM has no offices or personnel in the United States, and is subject to the laws and regulations of China.

³ All references to numbered exhibits herein ("Ex. ___") refer to the Respondents' Consolidated Exhibit List, as amended, dated June 21, 2013.

B. EYHM's Registration with the Public Company Accounting Oversight Board

EYHM registered with the Public Company Accounting Oversight Board ("PCAOB") on July 8, 2004. Ex. 1. Because it is subject to the laws of China and the regulations and directives of the CSRC and MOF, EYHM was not able to sign the registration form's "Consent to Cooperate with the Board and Statement of Acceptance of Registration Condition, Item 8.1 – Exhibit 8.1," which would have required EYHM to consent "to cooperate in and comply with any request for . . . the production of documents" made by the PCAOB. *Id.* at 16. Because EYHM could not agree to that provision, which would have been an incorrect statement of EYHM's capability under the Chinese law that governs its operations, EYHM provided a letter and a legal opinion from PRC legal counsel, which EYHM included as Exhibit 99.2 to PCAOB Form 1. *Id.* The letter and legal opinion explained in detail the conflicting PRC laws that were in effect in 2004 and that could prevent EYHM from complying with such a request from the PCAOB. Although EYHM could not sign the consent, it did agree "to take all reasonable steps to cooperate in and comply with any request for . . . the production of documents made by the PCAOB to the fullest extent permissible by applicable laws." *Id.* at 21. EYHM understood that other PRC-based firms that registered with the PCAOB received similar legal advice and provided similar explanations to the PCAOB. EYHM also understood that the laws of many other countries imposed limitations on the ability of firms in those countries to produce documents to the PCAOB, and that those firms also limited their consents to cooperate. The PCAOB approved EYHM's registration application despite the qualification concerning Chinese law, and neither the PCAOB nor the SEC has ever questioned the legal opinion attached to EYHM's application that made clear that PRC law would prevent EYHM from complying with certain information requests from U.S. regulators.

As the testimony and evidence presented at the hearing will demonstrate, EYHM has fulfilled its commitment to the fullest extent possible under the applicable laws. Moreover, since its initial registration, EYHM has been entirely transparent with the PCAOB and the Commission. EYHM has since filed an Annual Report (Form 2) with the PCAOB for each year

between 2005 and 2012, identifying in each year its continued inability to consent to the production of documents.⁴ *See, e.g.*, Ex. 35, at 20. EYHM has been mindful of the potential conflict between U.S. and PRC law and has, accordingly, even made note of the initiation of this proceeding in its disclosures to U.S. regulators. Ex. 38. However, it had always been the firm's expectation that the conflicts between U.S. and PRC law would be resolved by the U.S. and PRC governments or regulatory agencies, as they have in every other similar situation around the world in which local laws prevented non-US firms from consenting to provide documents requested by the PCAOB or SEC.⁵ In fact, as EYHM will demonstrate at the hearing, it relied on the fact that the US regulators would address the conflicting laws and resolve them, and built its PRC offices and trained very significant numbers of accountants based on its expectation that it would not be placed in the position of being forced to violate China law in order to comply with the Commission's Section 106 requests. So far as EYHM is aware, the Commission has never before brought a 102(e) proceeding against a firm for not producing documents when the laws of its local country prohibit that production.

C. EYHM's Client B and Client C Audit Engagements

At issue in this proceeding as to EYHM are Section 106 requests related to two former EYHM audit clients – Client B and Client C. With respect to both clients, the evidence adduced at the hearing will demonstrate that EYHM acted in good faith, undertook all efforts it could to satisfy the Division's requests short of committing direct violations of PRC law and flagrantly disobeying the repeated oral and written instructions of the PRC regulators. As Mr. Leung will describe, EYHM sought out legal advice from PRC counsel regarding the firm's obligations

⁴ The firm also supplied its consent under Section 106(b), dated February 28, 2011, which provides that EYHM will produce its audit work papers "to the extent permitted by applicable law of the [PRC]" Ex. 4.

⁵ "This is a government-to-government, sovereign-to-sovereign matter that can only be resolved through the agreement of relevant authorities in the United States and in China." Cynthia M. Fornelli, Executive Director, Center for Audit Quality, Testimony before the U.S.-China Economic and Security Review Commission on China's Financial Conditions and Their Impacts on U.S. Interest, (Mar. 7, 2013), http://www.uscc.gov/sites/default/files/3.7.13_Fornelli_Testimony.pdf.

under PRC law, repeatedly sought authorization from the CSRC and MOF to comply with the Commission's requests and offered to produce those documents, which were made ready to send at a moment's notice either to the SEC or the CSRC. The fact is, EYHM did not "willfully refuse" to produce anything: it tried in every way possible to comply with the Commission's requests, but, particularly after its repeated requests for authorization from its regulators were declined, it knew it would face severe sanctions, potentially including the dissolution of the firm and criminal prosecution of its personnel, had it ignored those instructions and sent the materials to the SEC.⁶

As further explained in DTTC's memorandum of law, EYHM's belief that it was obligated to notify the CSRC and MOF of the Commission's requests was well-founded and reasonable, and its concerns about the consequences of violating PRC law and the directions of its regulators were not speculative. The evidence at the hearing will show that, in fact, EYHM's belief that it would suffer severe sanctions if it provided documents directly to the Commission after the Chinese government instructed that it was a violation of law to do so is entirely sincere and well grounded in legal and practical experience.

1. Client B

Client B is a Delaware company headquartered in Beijing. Client B develops, manufactures, and distributes organic compound fertilizers in the PRC. It is a holding company that operates through three PRC-based, wholly-owned subsidiaries. Client B became listed on the NASDAQ Capital Market exchange in 2009. Ex. 2. In November 2010, EYHM was engaged by Client B, succeeding Client B's previous auditor (Crowe Horwath LLP, a U.S. registered accounting firm) to audit its financial statements for the fiscal year ending on March 31, 2010. EYHM was also engaged to report on the effectiveness of Client B's internal control

⁶ Other evidence, including the testimony of J. Randall Leali, the Asia Pacific Professional Practice Director of Ernst & Young Hong Kong, will show the affirmative, remedial steps taken in good faith by EYHM in response to its discovery of improprieties at Clients B and C. Also, EYHM may also offer the testimony of EY LLP (U.S.) and EY Global representatives to describe the impact that sanctions could have upon the U.S. and Global network, depending on the evidence offered in the Division's case.

over financial reporting as of December 31, 2010. However, EYHM never issued an audit report on Client B's financial statements.

Before it completed its audit work, in February 2011, an online investment research report raised questions about Client B's business, including its operations and reported revenue. In response to that report, Client B requested that EYHM perform additional audit and other procedures. During the course of the work it undertook, EYHM discovered that Client B had engaged in activities that constituted potential violations of U.S. securities laws. EYHM duly reported those facts to Client B, and ceased its audit work for Client B on March 8, 2011. On the same day, EYHM met with Client B's audit committee to discuss the potential violations, and requested that the committee take timely and appropriate actions to remedy them. On March 14, 2011, after additional meetings with Client B, EYHM was terminated without notice. The termination was announced in a press release filed with the SEC soon thereafter.⁷

Because of the facts it uncovered, and Client B's lack of remedial action in response, EYHM sent a report under Section 10A(b)(2) of the Securities Exchange Act ("Exchange Act"), 15 U.S.C. § 78j-1(b)(2), to Client B's board of directors.⁸ Client B's 10A letter was also sent to the company's CEO and the board chairman on March 15, 2011. In October 2012, the Commission entered a Cease and Desist Order against Client B and revoked its Registration of Securities. *See* Ex. 36.

2. Client C

Client C is a Cayman Islands corporation, headquartered in Beijing, which provides engineering and technology services primarily in the PRC. Client C became a publicly traded company through an initial public offering on November 3, 2010, and its securities were listed on the NASDAQ Stock Market LLC. At the time of its offering, Grant Thornton HK (now

⁷ Ex. 8.

⁸ Congress added Section 10A to the Exchange Act as part of the Private Securities Litigation Reform Act. Section 10A requires that an auditor report to the board of directors uncorrected illegal acts and that the issuer notify the SEC it has received a report. 15 U.S.C. §§ 78j-1(a)(1), (b)(3). The auditor must notify the Commission if the issuer fails to furnish the report to the Commission. *Id.* at (3)(B).

known as JBPB & Co.) was engaged as Client C's auditor. As a result of a merger with BDO Limited, Grant Thornton resigned as Client C's auditor on January 12, 2011. On February 28, 2011, EYHM was engaged to audit Client C's financial statements for the fiscal year ending on September 30, 2011. EYHM's report on the financial statements of Client C, dated March 31 2011, was the only audit performed by EYHM for Client C. It was included in Client C's Form 20-F filing with the Commission on March 31, 2011.

On August 16, 2011, an anonymous online blogging collective named "Alfred Little" published a report containing allegations of fraud against Client C. In response, Client C requested EYHM to perform certain agreed-upon audit procedures of its bank account statements. In the course of that work, EYHM determined that members of Client C's management likely engaged in illegal activities. EYHM attempted to, but was prevented from, completing its investigation to its satisfaction. Following its unsuccessful efforts to perform the agreed-upon procedures, on September 22, 2011, EYHM sent Client C's audit committee and special committee a report pursuant to Section 10A(b)(2) of the Exchange Act. Ex. 13. EYHM also resigned from its engagement on the same day and withdrew its audit opinion on Client C's September 30, 2010 financial statements. In December 2012, at the Commission's request, the United States District Court for the District of Louisiana entered a Final Judgment against Client C, permanently enjoining that Client from violating securities laws. Ex. 37.

D. EYHM's Efforts to Address the U.S. Regulators' Requests for Documents

1. The Voluntary Requests for Work Papers

On June 30, 2011, EYHM received a voluntary request from the Division for documents relating to audit work performed for Client B ("Client B Voluntary Request"). Upon receiving that request, EYHM sought advice from counsel regarding its obligations to notify the CSRC and MOF of the request,⁹ which it did in early July, 2011. (See letters of EYHM to CSRC and MOF,

⁹ PRC counsel advised EYHM that the Announcement of CSRC [2009] No. 29 ("Reg. 29") which is applicable to audit firms, requires those firms to notify the CSRC before providing or disclosing materials that may involve national security or vital interests of the PRC. Based on that advice and on discussions

both dated October 12, 2011 (Exs. 18 and 19), recounting EYHM's meetings with those regulators relating to the voluntary request.) At the July meetings with the CSRC and MOF, Mr. Leung explained the voluntary request EYHM had received and sought guidance on how the firm should respond to that request. Both the MOF and CSRC told Mr. Leung that EYHM was not permitted to provide work papers to the SEC in response to its voluntary request, and that the SEC should address any such requests to those authorities, not to EYHM directly. The regulators also told Mr. Leung that the SEC had assured them that the U.S. regulator had agreed that while it was negotiating with the PRC regulators, the SEC would not take any disciplinary action against firms like EYHM that received requests for production.

Following those meetings, EYHM obtained further advice of PRC counsel and responded to the Client B Voluntary Request on July 29, 2011. In its response, EYHM produced certain categories of documents and other information to the Division. Ex. 12. EYHM also advised the Division that other categories of documents, such as audit work papers, could not be produced under PRC law. EYHM provided the staff with a detailed legal memorandum, also dated July 29, 2011, prepared by EYHM's PRC counsel, which addressed the PRC laws applicable to the request and explained the reasons why those laws precluded production of certain documents.

In spite of its efforts to resolve the conflicts posed by the Division's request and PRC law, on October 5, 2011 EYHM received a separate request for documents from Division Staff relating to certain work performed for Client C ("Client C Voluntary Request").¹⁰

In response to the SEC's voluntary requests, and mindful of applicable PRC law, Regulation 29 and based on counsel's advice, EYHM notified the CSRC and MOF of the Client C Voluntary Request and a related request from the PCAOB. In its communication with the

with the CSRC, EYHM believes that Reg. 29 requires notification to the CSRC in the event any foreign regulator seeks production of documents from EYHM.

¹⁰ EYHM was not contacted by the Division to discuss its concerns about the production of its work papers for Client B until it received a Section 106 Request on May 1, 2012.

CSRC and MOF, EYHM requested another meeting to discuss the requests and to obtain guidance on whether and how it could provide documents to the SEC.

In response to its request, in early October, EYHM, through Mr. Leung, was told that the CSRC and MOF had received several similar inquiries from other China-based accounting firms that were registered with the PCAOB, and that the regulators wanted to meet with the six largest such firms (including all Respondents and one other firm). The regulators asked Mr. Leung to organize such a meeting.

That meeting was held on October 10, 2011. EYHM, the other Respondents and one other firm met with the CSRC's Chief Accountant and her staff and members of the MOF's Supervision and Inspection Bureau. The China regulators explained that the purpose of the meeting was to address the Commission's requests for production of work papers and other materials, and similar PCAOB requests. (In the case of EYHM, the PCAOB request sought Client C's audit work papers). At the meeting, both the CSRC and the MOF representatives stated very clearly that, in accordance with the relevant PRC laws, the firms could not provide work papers directly to foreign regulators. The CSRC and MOF representatives said that all such requests should be made to them, not the firms. The officials also told the firms that foreign regulators had agreed that they would not unilaterally punish PRC audit firms for not providing work papers. The officials also said that they would send the firms written guidance consistent with their directions.

Following the meeting, EYHM received an Accounting Department Letter dated October 26, 2011 ("October 26 Letter") that set forth the regulator's directions to EYHM (and the other firms) regarding the production of audit documents outside the PRC. Ex. 20. The CSRC letter provided the following instructions to PRC firms regarding the U.S. regulators' requests:

1. Foreign regulators who seek work papers and other archived documents should address those requests to the CSRC;
2. In response to requests to transmit work papers outside of China, EYHM must comply with the [Chinese] Securities Law, the CPA Law, the State Secrets Law, and the Archives Law; and

3. Transmission of work papers and other documents without authorization is a violation of PRC law.

The October 26 Letter marked a decisive development in the position of the PRC regulators regarding the firms' duties under China law: such a written instruction is rare, and, as the reports provided by Professors Tang and Feinerman explain, the Letter had the force of law over the Respondents – just as the Commission would presumably argue that a similar directive from it to one of its regulated entities would carry the force of law. As the evidence at the hearing will confirm, upon receiving the October 26 Letter, and reviewing it with its PRC counsel, EYHM understood that any question that may have previously existed regarding the obligation of the firms to notify the CSRC and MOF of any requests from US regulators was eliminated, and the firms were placed on clear notice that any direct production of work papers to US regulators without the specific authorization of the CSRC and MOF was a violation of law that would be punished.

Moreover, while Professor Clarke has belittled the October 26 Letter, suggesting that it does not prohibit the firms from complying with the SEC's requests, and, he even suggests, permits such production, none of EYHM's advisors and no one who attended the meeting or received the Letter agrees with that view. To the contrary, after receiving the October 26 Letter, EYHM was certain that if it were to produce the work papers to the SEC, it would be in flagrant violation of the oral and written instructions of its regulators and that such a defiant act would be severely punished. EYHM will provide testimony and evidence at the hearing to confirm the basis for its belief that it would have been irresponsible, indeed disastrous, for the firm and its partners to have sent work papers to the SEC after receiving the October Letter.

Based on its meetings with the Chinese regulators and the October 26 Letter, EYHM responded to the Division's Client C Voluntary Request, emphasizing its wish to cooperate with the Commission, but noting that it could not produce the requested materials without authorization of the Chinese government, which it had not received. EYHM reminded the

Division that it was subject to PRC laws and, again identified the applicable PRC laws and regulations, and included a copy and unofficial translation of the October 26 Letter. Ex. 21.

2. The December Meetings

Mr. Leung and other EYHM representatives continued to meet with officials from the CSRC in an effort to resolve the outstanding requests. However, at a meeting on December 8, 2011, the CSRC's Chief Accountant once again told Mr. Leung on behalf of EYHM that it was not permitted to provide the requested work papers without permission from the Chinese government. Specifically, the Chief Accountant informed EYHM as follows:

1. U.S. law – specifically, the Dodd-Frank Wall Street Reform and Consumer Protection Act – permits the PCAOB to obtain work papers from foreign regulators;
2. It was the CSRC's understanding that, upon registering with the PCAOB, EYHM (and the other China-based audit firms) represented as part of the process that it would not violate PRC laws; and
3. PRC firms are not allowed to provide work papers directly to parties outside China, whether the production of those work papers is prohibited by law or not. Foreign regulators who want access to work papers should seek to access those documents through a cooperative mechanism with the PRC regulators who will then determine whether to produce the work papers, in accordance with PRC laws.

Given the position of the CSRC and MOF, Mr. Leung will testify that on behalf of EYHM he offered to submit the requested work papers to the Chinese regulators for review and production to the Division and to the PCAOB. Moreover, Mr. Leung will state that EYHM has prepared the work papers for delivery to the SEC or the CSRC and is ready and willing to produce them as soon as the CSRC or MOF authorize it to do so. Until that time, EYHM is simply unable to produce the documents to the SEC, based on the specific directives of the CSRC, including as articulated in the October 26 Letter and at the December meeting.

3. The Section 106 Requests and EYHM's Continuing Efforts

On February 12, 2012 and May 1, 2012, EYHM was served with the Commission's requests pursuant to Section 106 – for Client C and B respectively. Upon the receipt of those requests Mr. Leung notified the CSRC and MOF of the requests and the position adopted by the

Commission against the firm. In response to those requests, the CSRC and MOF maintained their previously stated positions. Mr. Leung again offered to provide the requested materials to the CSRC, but has, to date, not received direction to make that delivery.

In late February 2012, EYHM learned that the PCAOB had taken a different approach to the issues, and had contacted the CSRC directly to request its assistance in obtaining production of Client C's work papers and other documents. In a February 22, 2012 letter, the PCAOB staff acknowledged that EYHM might "need the assistance of the relevant Chinese authorities to facilitate production of all relevant documents and information" to it. Ex. 24. At the PCAOB's request, EYHM notified the CSRC that it was ready to produce to the China regulators the work papers that were sought by the PCAOB. EYHM is aware that in May of this year, the PCAOB reached an agreement with the CSRC and MOF, documented in a Memorandum of Understanding ("MOU") on Enforcement Cooperation between the PCAOB, the CSRC, and the MOF, Ex. 274, which provides for production of work papers to the PCAOB and permits those work papers to be shared with the SEC.

Both before that MOU was announced and since, EYHM has continued to communicate and meet with officials from the Chinese regulators to resolve the requests. This included additional meetings with the PRC regulators between February and June 2012. Mr. Leung will testify about those meetings and communications with the CSRC and MOF, including a meeting held as recently as June 19, 2013.

E. Potential Repercussions to EYHM, Issuers, Investors and the Public Interest

The evidence adduced at the hearing will not only show that EYHM has not "willfully refused" to comply with the Division's requests, it will also demonstrate the significant adverse repercussions that would result from a ruling imposing sanctions on EYHM.

Mr. Leung will testify as to the numerous meetings he attended with the CSRC and MOF and will explain to the Law Judge that the message he has been given has remained the same – any production by EYHM to the Division would constitute a flagrant violation of PRC law and would subject EYHM to severe sanction.

The sanctions sought by the Division will not, and cannot, change PRC law or result in the production of the materials the Division seeks. Such a result can only be obtained through regulator-to-regulator channels. Instead, a sanction imposed on EYHM would serve no remedial purpose – the only permissible purpose of a Rule 102(e) sanction – but instead demonstrate that the Division can, effectively, punish any firm it chooses to by demanding that the firm commit a violation of foreign law.

An order barring EYHM from practicing or appearing before the Commission would have severe, negative consequences for the firm and the public, while leaving the underlying conflict of laws unchanged. First, if EYHM were barred from practicing before the Commission it would not be able to perform any work for US registrants – whether for China-based issuers or multinational U.S. issuers that receive substantial revenues from activity in the PRC. Since EYHM has expended great resources, both in time and money, training a large number of accountants to perform that work, it would suffer huge losses if it were barred from utilizing that part of its practice.

Second, because the work EYHM and the other Respondents perform for China-based and U.S. issuers would be prohibited, those clients would not only lose the services of their chosen auditors, any other auditor that could replace EYHM would itself become subject to the very same predicament should the Division issue a Section 106 demand. Third, if EYHM and the other Respondents are removed from serving the China-based and U.S. issuers, there would remain only a very small number of other registered firms that have limited resources and capability to perform audit work under US standards. The existing clients that need audit assistance will very likely not find adequate support from the remaining registered firms in the PRC. And, to the extent that the clients of EYHM and the other Respondents could find an auditor to replace them, those firms simply do not have the training and expertise that the Respondents have developed to do the work that is required under U.S. law.¹¹ Finally, as further

¹¹ See *In the Matter of Brock, Schechter & Polakoff, LLP*, PCAOB Release No. 105-2012-002 (May 22, 2012) (enforcement action against firm with no previous experience auditing under PCAOB standards or

described in the Pre-Hearing brief of KPMG, any sanction the Law Judge or the Commission might impose would have enormous negative consequences, while failing to remedy the current situation at all.

III. LEGAL STANDARD

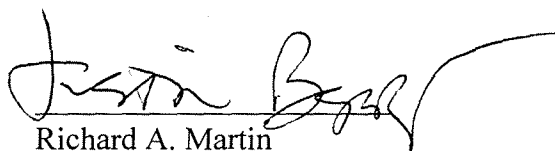
EYHM hereby adopts and incorporates by reference the statements and arguments set forth in DTTC's Pre-Hearing Brief.

IV. SANCTIONS

EYHM does not believe that there is any basis for sanctions in this matter, and joins KPMG Huazhen's Pre-Hearing Brief, hereby adopting and incorporating by reference the arguments made therein.

V. CONCLUSION

For the foregoing reasons, the Division cannot, and will not, be able to prove that EYHM violated Commission Rule 102(e) or that any sanction against EYHM is justified.



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auditing companies based in China, and no ability to understand or communicate in Chinese); *In the Matter of James R. Waggoner*, PCAOB Release No. 105-2012-002 (May 22, 2012) (enforcement action against one of that firm's individuals).