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 REBUTTAL DISCLOSURE OF ITS CHINESE LAW EXPERT

Pursuant to the Court's Order On Joint Motion To Amend Hearing and Prehearing Schedules, dated June 10, 2013 ("Scheduling Order"), the SEC's Division of Enforcement ("Division") hereby provides its rebuttal disclosure of the Division's Chinese law expert, Donald Clarke. Attached hereto is the Second Expert Report of Donald Clarke and accompanying exhibit.

Dated: July 1, 2013

Respectfully submitted,

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SECOND EXPERT REPORT OF DONALD CLARKE

July 1, 2013

Donald Clarke

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I. Introduction

1. My name is Donald Clarke. I am providing this expert report as a supplement to my first expert report, dated June 17, 2013, in the captioned administrative proceedings (the "First Clarke Report"). I hereby incorporate by reference Parts I and II thereof and the relevant Exhibits concerning my qualifications, my remuneration, the reasons for my retention as an expert, and the materials I have reviewed in preparing this report. In addition, I have reviewed the materials described in Exhibit 1 attached hereto.

2. I am providing this expert report in order to respond to certain points made in the following expert reports submitted on behalf of Respondents: (a) Expert Declaration of James V. Feinerman, dated June 17, 2013 (the "Feinerman Report"), and (b) Expert Report of Professor Xin Tang, dated June 17, 2013 (the "Tang Report").

3. The following is a summary of the opinions I present in this report:

    a. China does not enforce its own laws on archives and state secrecy with consistent vigor. For example, Respondents have not presented, and I have not found, any cases imposing criminal or civil sanctions for the unauthorized transfer of archives overseas.

    b. Respondents have yet to produce a document stating that notification to and authorization from the CSRC is necessary before work papers may be produced to overseas regulators. The documents produced so far merely instruct recipients to follow existing law.

    c. It is incorrect to assert that documents sent to recipients from the CSRC made it unnecessary for them to seek approvals from other relevant authorities such as the

State Secrets Bureau (the "SSB") or the State Archives Administration (the "SAA"). Those documents instructed recipients to follow existing law, and existing law called for recipients to seek approval from those bodies in appropriate circumstances.

d. Although the Tang Report cites a case involving the dissolution of an accounting firm by government authorities, the facts are too far removed from the current proceedings for it to be relevant.

e. The Feinerman Report is inaccurate in stating that anything not explicitly permitted is forbidden. Since it cannot be *literally* true either of Chinese culture or of Chinese law—obviously Chinese people do an infinite number of things every day that are not explicitly permitted by law—it must at least sometimes be false, and therefore we still must determine what Chinese law actually says about the production of work papers.

II. There Is Reason to Believe that China Does Not Always Vigorously Enforce Its Own Laws on Archives and State Secrecy

4. Paragraph 33 of the Feinerman Report states that "the Chinese government has enacted laws that give the government the sole authority to decide whether data and documents may be transmitted both within China and without or subject to discovery abroad, and the China [sic] government enforces those laws vigorously." In my opinion, as explained below, there is reason to believe that the Chinese government does not in fact enforce such laws with consistent vigor.

5. The laws in question are chiefly those concerning the Law on the Protection of State Secrets and associated regulations and the Archives Law and associated regulations. Regulation 29, which all parties agree is a key regulatory document in this matter, was jointly issued by the China Securities Regulatory Commission (the "CSRC") and by the two agencies respectively responsible for the administration of the State Secrets Law and the Archives Law, *i.e.*, the State Secrets Bureau (the "SSB") and the State Archives Administration (the "SAA"). A substantial part of the Tang Report is devoted to a discussion these two laws.

6. It is important to note that when the Feinerman Report speaks about the concern of these laws with transmission of information "without" China or "abroad", these terms have a special meaning in the regulatory regime for state secrets and archives. Specifically, the territorial border with which these laws are concerned is not the border of the People's Republic of China, but rather the border between territory entirely controlled by the Communist Party of China and territory not so controlled. The latter territory includes, for example, Hong Kong and Macau, even though they are part of the People's Republic of China. This is why the text of the laws in question speaks of transmission "outside of mainland China" (*jingwai*) and not simply "abroad" or "to foreign countries".

7. If the Respondents regularly transmit work papers and other documents—in particular, work papers and documents of the kind they assert fall under the very broad scope of the State Secrets Law and the Archives Law—to overseas (including Hong Kong and Macau) entities without the appropriate authorizations from the SSB and the SAA respectively, and do not suffer sanctions as a result, that would suggest that the laws in question are not enforced with

consistent vigor, and moreover that they could be considered "blocking statutes"[1] of the kind to which courts pay less deference.[2]

8. In particular, the Archives Law and related regulations as they apply to this case would seem to qualify as blocking statutes in important respects. If, as asserted in the Tang Report, the relevant work papers are indeed "archives" under Article 16 of the Archives Law,[3] then Article 18 prohibits the unauthorized transfer out of mainland China *even of copies* of such work papers. I know of no parallel prohibition on the unauthorized transfer of copies of privately-owned archives within mainland China.[4]

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[1] Blocking statutes are described in the Restatement of the Foreign Relations Law of the United States:

> Blocking statutes are designed to take advantage of the foreign government compulsion defense . . . by prohibiting the disclosure, copying, inspection, or removal of documents located in the territory of the enacting state in compliance with orders of foreign authorities. Some statutes cover all documents, some only certain categories (for instance, documents related to merchant shipping or to production of uranium); some statutes apply of their own force, some when invoked by minister or comparable official, and some are applicable unless a waiver is obtained from the competent official or a local court directs that the documents be produced. All blocking statutes appear to carry some penal sanction.

RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 442 Reporters' Note 4 (1987).

[2] *See* Societé Nationale Industrielle Aérospatiale v. United States District Court for the Southern District of Iowa, 482 U.S. 522, 544 n. 28 (1987)

[3] *See* Tang Report, Paras. 59, 60.

[4] The Archives Law and its related regulations as applied to the work papers in this matter do not fit the Restatement's definition perfectly. First, they do not carry a penal sanction for unauthorized transfer (penal sanctions applying only to the unauthorized transfer of state-owned archives), *see* First Clarke Report, Para. 40, although I note that the Respondents' position is that they do, *see, e.g.,* Tang Report, Para. 59; Ernst & Young Hua Ming LLP Client C Wells Submission, at 19-20 (ENF Exhibit 150). Second, they apply by their terms to all overseas transfers, not just transfers to foreign authorities. Given the vast volume of the information flow across the borders of mainland China, however, and the fact that the Respondents have not cited any examples of any person or entity being punished in any way for the unauthorized overseas transfer of copies of archives, it is reasonable to conclude that a great deal of material arguably falling under a broad definition of "archives" has in fact been transmitted overseas without sanctions having been imposed on the transmitting party. If so, that would in turn suggest that the Archives Law in this case is being applied selectively for its blocking effect.

I note in this regard that a search I conducted in June 2013 in a major legal database established by Beijing University, pkulaw.cn, failed to find any cases involving criminal or administrative sanctions

9. I do not have personal knowledge as to the degree to which the Respondents transmit work papers and other documents to overseas entities such as affiliated accounting firms in Hong Kong, the United States, or other countries. I note, however, that at least some of the Respondents, in the promotional material on their web sites, appear to offer the services of persons outside of Mainland China (*i.e.*, personnel located in Hong Kong and foreign countries) in the provision of services to Chinese clients.

10. For example, in a statement addressed to Chinese clients, Respondent KPMG Huazhen states:

> KPMG has specifically set up the Global China Practice (GCP) to assist clients in addressing the above challenges. GCP has a dedicated team of senior management and staff in Beijing, and it has also set up more than 40 China Practices at various levels across regions that are major sources of or destinations for China investments. This platform brings together professionals, expertise, insights and experience across the KPMG global network to assist enterprises in bridging information gaps and cultural differences through working with our partners around the world. [5]

11. Respondent DTTC has, according to its web site, a "Chinese Services Group" that "works closely with Chinese companies seeking overseas expansion opportunities."[6] According to DTTC,

> the CSG network positions its practitioners in the local market to allow seamless and effective service to our clients on all China-related issues.
>
> Starting with just a few members several years ago, the CSG has grown to include coverage in over 120 locations around the world spanning six continents . . . .

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for the unlawful transfer of archives or copies thereof. Nor could I find any such cases on the web site of the SAA. This does not, of course, mean that no such cases exist, but these are two sources that would seem the most likely to have any that do exist. The CSRC's web site, for example, carries reports of disciplinary sanctions imposed by the CSRC.

[5] *KPMG's Global China Practice: Your Partner on the Road Ahead*, http://www.kpmg.com/cn/en/IssuesAndInsights/ArticlesPublications/Pages/Global-China-Practice-201109.aspx.

[6] *Chinese Services Group*, http://www.deloitte.com/view/en_CN/cn/services/csg/index.htm.

12. It is difficult to understand how such services could be provided without the transmission of *any* documents and information across the borders of Mainland China, including transmission into Hong Kong. In particular, I note that the audit reports for Client D for the year ending December 31, 2010, and for Client F for the year ending December 31, 2009, were signed by the KPMG affiliated firm in Hong Kong ("KPMG HK"), not China-based Respondent KPMG Huazhen.[7] It is difficult to understand how KPMG HK could have conducted an audit without any information now asserted by Respondents to be subject to the Law on State Secrets and the Archives Law having been transmitted into Hong Kong or revealed to individuals living in Hong Kong or abroad.

13. If any Respondents have engaged in such transmission without first seeking authorization from the SSB, the SAA, and other entities as relevant, this suggests either that the reach of such laws is not in practice as broad as they assert or that such laws are not enforced with consistent rigor.

III. Legal Obligations Created by CSRC Documents

14. I wish to address the statements in Paras. 36 and 37 of the Feinerman Report respecting what new legal obligations, if any, are created by the various documents and communications issued by the CSRC to the Respondents.

15. I agree with Prof. Feinerman's statement in Para. 36 that the October 26 Reply "does not purport to create new law, but recapitulates the relevant Chinese law, reminding Chinese accounting firms of their pre-existing obligations under Chinese law". In the next paragraph,

[7] *See* Respondent KPMG Huazhen's Pre-Hearing Brief, at 6-8 (filed June 24, 2013); 2010 Form 10-K for Client D, filed March 6, 2011 (ENF Exhibit 62); 2009 Form 10-K for Client F, filed March 15, 2010 (ENF Exhibit 80).

Prof. Feinerman properly places importance on what the CSRC is willing to put into writing. This means, however, that we must also pay attention to what the CSRC has *not* put into writing. Prof. Feinerman agrees that the October 26 Reply does not create any new legal obligations. The same can be said for all the other written communications from the CSRC produced by Respondents as well as (with respect to off-site inspections) Regulation 29.[8]

16. It is not disputed that providing documents overseas could at least in some circumstances require authorization from the SSB and the SAA. But the Respondents have not yet produced a document requiring CSRC authorization for providing documents overseas in connection with an offsite inspection. They have merely provided a number of documents instructing Respondents to obey existing law, whatever that might be.

17. On this point, I note that the translation of the October 26 Reply contained in the text of the Feinerman Report and attached to my own First Clarke Report is in my opinion highly misleading and needs clarification.[9] I agree with the different translation of the October 26 Reply attached to the Tang Report.[10] The translation of the last paragraph of the Reply, as set forth in the Feinerman Report, states: "Any breach of the [relevant] laws, rules and regulations, including providing working papers and other documents without authorization, would be held legally responsible by our relevant departments, according to the law." A much clearer translation, which I shall take from Item 4, Exhibit 2 of the Tang Report, is as follows: "Those[] who[,] *in violation of* the relevant laws, regulations and provisions, provide

[8] I make this point in detail in the First Clarke Report and will not repeat the arguments here.

[9] *See* Feinerman Report, Para. 36; First Clarke Report, Exhibit 4, Item 2. I am not suggesting any attempt to mislead by Prof. Feinerman. Apparently in both cases the misleading translation is taken from an attachment to the letter from Robert Cohen to Marc Johnson concerning Client B, dated May 25, 2012 (ENF Exhibit 47), although it is possible that the translation appears in other correspondence connected with these proceedings.

[10] Tang Report, Exhibit 2, Item 4.

the audit archives and other documents overseas without authorization shall be subject to legal liabilities imposed by the relevant government departments."[11] In other words (recalling the Prof. Feinerman and I agree that the October 26 Reply does not establish new legal obligations), providing documents overseas without authorization is a violation of law *only when existing law requires such authorization.*

18. I am aware that at least some Respondents have stated that they have received unambiguous *oral* instructions from CSRC officials stating that they may not turn over work papers to the SEC without authorization from the CSRC itself. What is striking, however, is that the CSRC has not been willing to put such instructions in writing.[12]

IV. Respondents Were Required to Seek Approvals from Authorities Other than the CSRC

19. I wish to address the statement in Para. 41 of the Tang Report that "the [October 26, 2011] Reply[13] indicating the CSRC and MOF's position that no direct provision of audit work papers should be made to foreign regulators without authorization, clearly makes it unnecessary for the Respondents to seek approval from or report to the other relevant Chinese authorities."

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[11] October 26 Reply, Para. 4 (emphasis added). Other than shifting a misplaced comma (which does not change the meaning), I am quoting Prof. Tang's translation verbatim.

[12] *See generally* First Clarke Declaration, Para. 44, and especially note 32 (citing the kind of unambiguous oral instruction that the Respondents have stated they have received that is missing from the written documents in this case).

[13] The "Reply" refers to a document cited in Para. 11 of the Tang Report, translated there as "CSRC's Replying Letter Concerning Providing Archive Files (Including Audit Workpapers) Overseas by Certain CPA Firms dated October 26, 2011" and included as Item 4 of Exhibit 2 to the Tang Report (hereinafter "October 26 Reply").

20. What the October 26 Reply says is that audit work papers may not be provided without authorization *in violation of the law*. That is what the translation supplied by Prof. Tang states:

> Those[] who[,] in violation of the relevant laws, regulations and provisions, provide the audit archives and other documents overseas without authorization shall be subject to legal liabilities imposed by the relevant government departments.[14]

21. The critical question then becomes: what authorizations from what body are required under law? Para. 2 of the October 26 Reply refers to a number of potentially applicable laws, and Para. 4 reminds addressees of their obligation to obey relevant laws. As noted above, Professor Feinerman and I agree that the October 26 Reply imposes no new legal obligations. No obligation to seek authorization from the CSRC is stated in the October 26 Reply, and as I have discussed above and in the First Clarke Report, no such obligation appears in the part of Regulation 29 dealing with requests for off-site inspections. The authorization referred to in Para. 4 clearly means authorization required by "relevant laws, regulations and provisions". All parties agree that "relevant laws" include the State Secrets Law and the Archives Law. Thus, authorization could be required from the relevant local branch of the State Secrets Bureau or the State Archives Administration, depending on the nature of the requested documents. Far from making it "unnecessary for the Respondents to seek approval from or report to the other relevant Chinese authorities", the October 26 Reply *commands* them to do so for certain types of documents. This is true even if one assumes that approval from the CSRC is required.

[14] October 26 Reply, Para. 4. Other than shifting a misplaced comma (which does not change the meaning), I am quoting Prof. Tang's translation verbatim.

22. In Para. 48(c) of the Tang Report, Professor Tang cites the language of the October 26 Reply quoted above[15] in support of his assertion that "it is clear that if any of the Respondents provides the Audit Workpapers directly to the SEC it will impede the CSRC's authority and violates the relevant Chinese laws giving the CSRC such authority." But it is implausible to suppose that in using the term "relevant government departments" who would impose legal liability in the event "relevant laws, regulations and provisions" were violated, the CSRC was referring to itself. Even were it undisputed that the CSRC had authority to regulate Chinese accounting firms in matters unrelated to Chinese securities markets, what *is* disputed is whether there exists any document, whether issued by the CSRC or any other regulatory or legislative body, that exercises that authority in the way asserted by the Respondents—*i.e.*, requiring notice to and approval by the CSRC for off-site inspections. The language from Para. 3 of the October 26 Reply cited in Para. 48(b) of the Tang Report is, by its terms, an instruction to overseas regulators. One cannot find here an instruction to audit firms to obtain CSRC approval before transmitting papers to overseas regulators.

V. Can a Sanction of Dissolution Be Imposed on an Accounting Firm?

23. I wish to address the statement in Para. 34 of the Tang Report regarding the possibility of the MOF or a subordinate agency at the provincial level (together, the "Financial Authorities") issuing an order dissolving any of the Respondents. According to the Tang Report, administrative penalties, including dissolution, can be imposed on an accounting firm by Financial Authorities for a violation of the Interim Measures for the Examination, Approval and Supervision of Accounting Firms (the "MOF Supervision Measures"). The Tang Report further mentions a specific case which, it states, demonstrates that an accounting firm has

[15] *See* Para. 20, *supra*.

actually been dissolved for violation of the MOF Supervision Measures.[16] In my opinion, this case is not relevant to the current proceedings, since it demonstrates only what I believe is not disputed, *i.e.*, that Financial Authorities have the power in certain circumstances to dissolve or revoke the license of accounting firms. In the case in question, the firm was dissolved because it had violated the MOF Supervision Measures by failing to make truthful and complete statements when applying for a license. Such circumstances are very far removed from those in the current proceedings.

VI. It Is Inaccurate to Say that Anything not Explicitly Permitted Is Forbidden

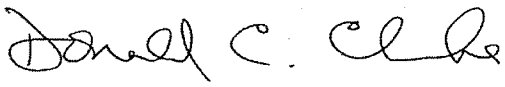
24. Finally, I wish to address the statement in Para. 41 of the Feinerman Report that "[i]n China, the cultural assumption is that *any action*, such as releasing documents or information, not explicitly prohibited is not allowed unless specially authorized" (emphasis added). I disagree with this statement both as applied to Chinese culture and as applied to Chinese law.

25. First, the statement obviously cannot be literally accurate. There is no law specifically authorizing Chinese citizens to breathe, or to take the bus to the park on Sunday, or to do any of the infinite actions they take every day. It might seem an absurdity to take the statement literally, but the point is that if the statement is not literally accurate, then it is not accurate at all: it turns out that one can indeed take *some* actions without specific authorization. That being so, we must therefore go back to doing what both sides have so far been doing in this case: discussing whether actual prohibitions exist with respect to the actions contemplated in this matter.

[16] The case in question is called "Appellate Case on Disputes Regarding a Dissolving Penalty Between Shanghai Municipal Finance Bureau and Shanghai Kaiwu Accounting Firm" in the Tang Report. The decision is available at http://pkulaw.cn/CLI.C.320295.

26. Second, I disagree with the statement even if its scope is limited to the release of documents and information. Chinese citizens constantly transmit letters, documents, telephone calls, text messages, and emails both within China and overseas[17] without specific permission to do so. When they get in trouble from the authorities for doing so, it is for violating a prohibition, not for failing to obtain a permit. A permit is necessary only if there is a specific law requiring one and prohibiting transmission without it. There is no overarching principle in Chinese law that a special authorization is required for "any action".

Submitted by:



Donald Clarke
July 1, 2013

[17] As always, for the purpose of these proceedings it is important to stress that Chinese law regarding state secrets and archives is typically concerned not with the border between China and foreign countries, but with the border between a narrower concept of China—the area under the immediate control of the Communist Party—and areas not so controlled even though they may be part of the People's Republic of China. Such areas include of course foreign countries, but also include Hong Kong and Macau. This narrower concept of China is frequently represented by the term "mainland China", and territories outside of mainland China are referred to as "overseas", since they are not necessarily "foreign".

Exhibit 1

List of Documents Reviewed or Relied Upon

1. *Documents Incorporated by Reference*

   a. All documents listed in Exhibit 3 to the Expert Report of Donald Clarke, dated June 17, 2013

2. *Filings in Legal Proceedings*

   a. Expert Declarations and Reports in the Current Proceeding

      i. Expert Declaration of James V. Feinerman, dated June 17, 2013

      ii. Expert Report of Professor Xin Tang, dated June 17, 2013

   b. Pre-Hearing Briefs in the Current Proceeding

      i. Division of Enforcement's Pre-Hearing Brief, dated June 24, 2013

      ii. Respondent Dahua CPA Co., Ltd.'s Pre-Hearing Brief, dated June 24, 2013

      iii. Respondent DTTC's Pre-Hearing Brief, dated June 24, 2013

      iv. Respondent KPMG Huazhen's Pre-Hearing Brief, dated June 24, 2013

      v. Respondent PwC Shanghai's Pre-Hearing Brief, dated June 24, 2013

      vi. Respondent Ernst & Young Hua Ming LLP's Pre-Hearing Brief, dated June 24, 2013