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UNITED STATES OF AMERICA  
Before the  
SECURITIES AND EXCHANGE COMMISSION

ADMINISTRATIVE PROCEEDING  
File No. 3-17112



In the Matter of

FRAZER FROST, LLP; SUSAN WOO, CPA; and  
MIRANDA SUEN, CPA,

Respondents

**MEMORANDUM OF LAW IN SUPPORT OF RESPONDENTS' MOTION TO DISMISS  
CERTAIN CLAIMS IN THE ORDER INSTITUTING PROCEEDINGS**

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Dated: April 5, 2016

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Respondents Frazer Frost, LLP (“Frazer Frost”), Susan Woo (“Woo”), and Miranda Suen (“Suen”) (collectively, “Respondents”) respectfully submit this memorandum of law in support of their motion, pursuant to Rule 154 of the Rules of Practice of the Securities and Exchange Commission (the “Commission”), to dismiss certain claims in the Commission’s Order Instituting Public Administrative and Cease-and-Desist Proceedings (“OIP”) based on the doctrine of judicial estoppel. Respondents respectfully move to estop the Commission from asserting during the Administrative Proceeding that Respondents failed to recommend that China Valves Technology, Inc. (“China Valves,” “CVVT,” or the “Company”) make revisions to its third quarter Form 10-Q and to dismiss all claims in the OIP based on that assertion on the grounds that the Commission’s claims are estopped by the doctrine of judicial estoppel due to the Commission’s inconsistent position in its action against China Valves.

#### **PRELIMINARY STATEMENT**

The Commission respectfully should be estopped from taking two contrary positions, particularly simultaneously. In the Commission’s complaint against China Valves, it asserted that China Valves’ auditors — the Respondents in this proceeding — recommended that China Valves make revisions to its 2010 third quarter Form 10-Q but the Company failed to make the recommended revisions. Now, when that claim no longer serves it, the Commission asserts the exact opposite position in its OIP against the Respondents, and claims that the Respondents failed to recommend that China Valves modify its 2010 third quarter Form 10-Q. These two positions are incompatible, and the doctrine of judicial estoppel should apply here to prevent a party from gaining an advantage by taking one position, and then seeking a second advantage by taking an incompatible position.

On September 29, 2014, the Commission filed a complaint against China Valves, its Chairman, its CFO, and its former CEO (the “China Valves Complaint”) alleging that China

Valves' "auditors [*i.e.*, Respondents] recommended that [it] make revisions to its third quarter Form 10-Q to correct its disclosure of the acquisition in response to information they had learned ... but [China Valves] failed to make the recommended changes." China Valves Complaint at ¶¶31-32. The Commission settled with China Valves and its Chairman and CFO, but did not settle with the former CEO, Jianbao Wang. According to the Commission, "the litigation is continuing against Wang," and the China Valves Complaint has not been amended. *See* SEC Litigation Release No. 23266 (May 20, 2015). Despite continuing to allege that China Valves' "auditors recommended that" [it] make revisions to its third quarter Form 10-Q" and that the Company "failed to make the recommended changes," the Commission filed the OIP in this action on February 11, 2016, and alleged that Respondents failed to recommend that China Valves make revisions to its third quarter Form 10-Q, directly contradicting its allegations in the China Valves Complaint. *See* OIP at ¶15.

When determining whether judicial estoppel is appropriate, courts consider three non-exclusive factors: (1) whether the party's later position is "clearly inconsistent" with an earlier position; (2) the party's success in persuading a court to accept an earlier inconsistent position; and (3) "whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the opposing party if not estopped." *New Hampshire v. Maine*, 532 U.S. 742, 750-51 (2001). Because the Commission previously asserted otherwise in the China Valves Complaint and used that assertion to its advantage, it is clearly estopped from now claiming that Respondents did not recommend that China Valves revise its Form 10-Q for the following reasons.

First, the Commission's current position in the OIP is patently inconsistent with the Commission's position in the China Valves Complaint. Second, the Commission has

successfully settled the China Valves litigation against China Valves and its Chairman and CFO, and therefore has been successful in persuading a court to accept its earlier inconsistent position. Lastly, it is clear that the Commission's recent change in position unfairly disadvantages Respondents since the allegation that Respondents failed to recommend that China Valves amend its Form 10-Q is central to the allegations in the OIP regarding Respondents' conduct concerning the 2010 third quarter Form 10-Q. *See* OIP ¶¶ 5-22, 72-77.

### **STATEMENT OF FACTS**

According to the Commission's allegations in the OIP, China Valves purchased a company called Changsha Valve from Watts Water Technologies, Inc. ("Watts Water") in January 2010. OIP at ¶5. On October 7, 2011, during its 2010 third quarter interim review of China Valves in connection with China Valves' acquisition of Changsha Valve, Respondent Woo received an email, sent to an analyst, from Jianbao Wang, China Valves' then CEO (the "Wang Email"). OIP at ¶¶9-10. The Wang Email contained information about China Valves' acquisition of Changsha Valve that was inconsistent with, or had not been included in, China Valves' previous disclosures. Specifically, the Wang Email stated, among other things, that Changsha Valve was previously a subsidiary of Watts Water, China Valves made the acquisition through an entity called Able Delight, and only approximately \$6.1 million of the total \$15 million cost of the transaction had been paid directly to Watts Water, with the remainder paid to other entities. OIP at ¶11.

The Commission then alleges in the OIP that "[a]lthough Respondents verified during their 2010 third quarter review that the information in the Wang Email was correct and that [China Valves'] 2010 financial statements included in Forms 10-Q misstated the acquisition, Respondents failed to . . . recommend modifications to [China Valves'] management or audit committee to make the Form 10-Q conform to [GAAP]." OIP at ¶15. However, the

Commission's allegation in the OIP directly contradicts its claim in the China Valves Complaint.<sup>1</sup> In the China Valves Complaint, the Commission asserted that China Valves' "auditors recommended that [it] make revisions to its third quarter Form 10-Q to correct its disclosure of the acquisition in response to information they had learned ... but [China Valves] failed to make the recommended changes." China Valves Complaint at ¶¶31-32. On May 14, 2015, the Commission settled with China Valves and its Chairman and CFO, and the Court entered final judgments, imposing numerous penalties. The Commission's action against the former CEO of China Valves, Jianbao Wang, remains pending and the Commission has not amended the China Valves Complaint. *See* SEC Litigation Release No. 23266 (May 20, 2015).

As asserted in the OIP, PCAOB standards call for auditors to bring the type of information in the Wang Email to the appropriate level within the audit client, culminating with the audit committee or others with equivalent responsibility. *See* PCAOB AU 722.29, OIP at ¶19. As stated in the China Valves Complaint, the Respondents recommended that China Valves make revisions to its 2010 third quarter Form 10-Q, but the Company failed to make the recommended revisions. Even though China Valves failed to correct its third quarter 2010 Form 10-Q, Respondents nonetheless raised this issue with the Company prior to the filing. In addition, the Company subsequently took prompt corrective action by filing a Form 8-K/A three days after the Form 10-Q was filed. *See* China Valves Complaint at ¶ 32 ("Once CVVT's

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<sup>1</sup> In addition to contradicting its own complaint, the Commission's assertion in the OIP that the auditors failed to recommend to China Valves' management and audit committee that the Form 10-Q be revised will be contradicted at the Administrative Hearing by the evidence, including, among other things, evidence that Respondents informed China Valves of the issues raised by the new information in the Wang Email; undertook additional procedures to verify payments made in connection with the acquisition; and, recommended that China Valves make revisions to its third quarter 2010 Form 10-Q (including in emails to China Valves' U.S. counsel, in which Respondents stated "[o]ur concern is the disclosure of this event" and "[w]e need to update the 10Q"), despite the fact that China Valves failed to make any changes.

independent board members learned of the actual details of the acquisition, they insisted that CVVT management issue the amended Form 8-K (“Form 8-K/A”) on November 18, 2010, *correcting the company’s prior disclosures.*) (emphasis added). Notably, the fact that the Company took corrective action three days after it filed its 2010 third quarter Form 10-Q was not mentioned in the OIP.

Because of its prior inconsistent position in the China Valves Complaint and the Commission’s use of that assertion to its advantage to obtain a successful resolution of that litigation, the Commission is judicially estopped from now asserting claims in the OIP that Respondents failed to recommend that China Valves modify its 2010 third quarter Form 10-Q.

#### **LEGAL STANDARD**

“Judicial estoppel, sometimes also known as the doctrine of preclusion of inconsistent positions, precludes a party from gaining an advantage by taking one position, and then seeking a second advantage by taking an incompatible position.” *Rissetto v. Plumbers & Steamfitters Local 343*, 94 F.3d 597, 600 (9th Cir. 1996). The purpose of the doctrine is to ensure the integrity of the judicial process. *See Russell v. Rolfs*, 893 F.2d 1033, 1037 (9th Cir. 1990) (“The policies underlying preclusion of inconsistent positions are general considerations of the orderly administration of justice and regard for the dignity of judicial proceedings. . . . Judicial estoppel is intended to protect against a litigant playing fast and loose with the courts.”) (internal quotation marks omitted).

The Supreme Court has identified three non-exclusive factors that may be considered when determining whether judicial estoppel is appropriate: (1) whether the party's later position is “clearly inconsistent” with an earlier position; (2) the party's success in persuading a court to accept an earlier inconsistent position; and (3) “whether the party seeking to assert an inconsistent position would derive an unfair advantage or impose an unfair detriment on the



opposing party if not estopped.” *New Hampshire v. Maine*, 532 U.S. 742, 750-51 (2001); *see also Moses v. Howard Univ. Hosp.*, 606 F.3d 789, 798 (D.C. Cir. 2010) (a court may invoke judicial estoppel “[w]here a party assumes a certain position in a legal proceeding. . . , succeeds in maintaining that position. . . , [and then], simply because his interests have changed, assume[s] a contrary position.”) (internal quotation marks and citations omitted). These factors are not “inflexible-prerequisites or an exhaustive formula for determining the applicability of judicial estoppel,” and “[a]dditional considerations may inform the doctrine's application in specific factual contexts.” *New Hampshire*, 532 U.S. at 751.

### ARGUMENT

The application of these factors here demonstrates that the Commission is estopped from claiming now that Respondents did not recommend that China Valves revise its Form 10-Q after the Commission previously asserted otherwise in the China Valves Complaint.

First, the Commission’s position in the OIP is clearly inconsistent with the Commission’s position in the China Valves Complaint. The Commission previously alleged that China Valves “misrepresented the [Changsha Valve] transaction to its auditors,” and that after learning the actual details of the transaction, “CVVT’s auditors recommended that [it] make revisions to its third quarter Form 10-Q to correct its disclosure of the acquisition in response to information they had learned . . . but CVVT failed to make the recommended changes.” China Valves Complaint at ¶¶31-32.

In contrast, the Commission now claims that Respondents failed to recommend that China Valves revise its third quarter Form 10-Q. *See* OIP at ¶21 (“Respondents failed to raise the inaccuracies with CVVT management or CVVT’s audit committee[.]”). Where a party asserts “directly contradictory positions; necessarily, they are ‘clearly inconsistent.’” *U.S. v. Liquidators of European Fed. Credit Bank*, 630 F.3d 1139, 1149 (9th Cir. 2011). These two

arguments cannot be reconciled as the Commission plainly contradicts itself. The Commission's position in the China Valves litigation is therefore clearly inconsistent with the position it has now takes in the OIP to its advantage.

The doctrine of judicial estoppel applies here even though the proceeding against Respondents is separate from the action against China Valves. *See Risetto*, 94 F.3d at 605 (“[T]he doctrine of judicial estoppel is not confined to inconsistent positions taken in the same litigation.”). Indeed, estoppel is even more appropriate here, where the incompatible statements have been made in two different cases, since “[i]nconsistent positions in different suits are much harder to justify” than inconsistent pleadings within one suit. *Astor Chauffeured Limousine Co. v. Runnfeldt Investment Corp.*, 910 F.2d 1540, 1548 (7th Cir. 1990); *see also Kale v. Obuchowski*, 985 F.2d 360, 361 (7th Cir. 1993) (“[A] party who prevails in the first case by asserting some proposition may not seek to prevail in a later case by asserting its opposite.”); *Patriot Cinemas, Inc. v. General Cinema Corp.*, 834 F.2d 208, 212 (1st Cir. 1987) (“[T]he doctrine precludes a party from asserting a position in one legal proceeding which is contrary to a position it has already asserted in another.”); *Allen v. Zurich Ins. Co.*, 667 F.2d 1162, 1167 (4th Cir. 1982) (affirming district court's finding that party estopped from asserting position inconsistent with earlier position in state court proceeding).

The second factor is likewise satisfied because the Commission has successfully settled the China Valves litigation and therefore has been successful in persuading a court to accept its earlier inconsistent position. On May 14, 2015, Judge Reggie B. Walton of the United States District Court for the District of Columbia entered final judgments against China Valves and its Chairman and CFO, imposing numerous penalties. In connection with the entry of final judgments in this case, the Commission issued a press release touting that the “SEC Obtains

Final Judgments Against China Valves Technology, Inc. and Two Senior Officers in Fraud Case.” SEC Litigation Release No. 23266 (May 20, 2015). Favorable settlements are equivalent to winning a judgment for the purposes of judicial estoppel. *See Risetto v. Plumbers and Steamfitters Local 343*, 94 F.3d 597, 604-05 (9th Cir. 1996) (concluding a favorable settlement is the “equivalent to winning a judgment for purposes of applying judicial estoppel”); *Commonwealth Ins. Co. v. Titan Tire Corp.*, 398 F.3d 879, 887 (7th Cir. 2004) (concluding a “favorable settlement . . . may be sufficient to show that the party to be estopped prevailed in the prior case regardless of whether a judicial decision was obtained”).<sup>2</sup> “[J]udicial acceptance of an inconsistent position in a later proceeding . . . create[s] the perception that either the first or the second court was misled,” thus posing a threat to judicial integrity. *See Maine*, 532 U.S. at 750 (internal quotation marks omitted). The Commission cannot dispute that it has successfully settled the China Valves litigation.

Lastly, the third factor is satisfied as it is self-evident that the Commission’s recent change in position unfairly disadvantages Respondents. The Commission’s allegations in the OIP largely rely upon the theory that Respondents failed to recommend that China Valves make revisions to its third quarter Form 10-Q. The Commission previously achieved a successful resolution of its litigation against China Valves by relying on the opposite position, alleging that China Valves ignored its auditors and “failed to make the recommended changes” made by its

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<sup>2</sup> Respondents recognize that the D.C. Circuit has previously suggested that a settlement agreement may not qualify as prior success for the purposes of judicial estoppel. *See Konstantinidis v. Chen*, 626 F.2d 933, 939 (D.C. Cir. 1980). However, that case was decided more than twenty years prior to the Supreme Court’s decision in *New Hampshire v. Maine*, at a time when the D.C. Circuit did not recognize the judicial estoppel doctrine. *See Moses*, 606 F.3d at 798 (“Since *Maine*, this court has recognized and applied the doctrine as instructed by the Supreme Court.”). Therefore, the holding in *Konstantinidis* should no longer be considered controlling law. In any case, Respondents reside in the Ninth Circuit and any appeal could be heard in that Circuit. *See* 15 U.S.C. § 78y(a)(1), 15 U.S.C. § 77i.

auditors. *See* China Valves Complaint at ¶32 (“CVVT’s auditors recommended that [it] make revisions to its third quarter Form 10-Q to correct its disclosure of the acquisition in response to information they had learned ... but CVVT failed to make the recommended changes.”). The Commission should not be permitted to take advantage of the argument that China Valves ignored and failed to take the advice of its auditors in its litigation against the Company and its officers, and then take the opposite position in its litigation against the Company’s auditors when that claim no longer suits the Commission’s purposes. Allowing the Commission to change its theory to permit it to pursue new and inconsistent claims against Respondents amounts to an unfair disadvantage supporting the application of judicial estoppel.

Further, as noted above, “[t]he litigation is continuing against Wang [the former CEO of China Valves].” SEC Litigation Release No. 23266. The Commission has not amended the China Valves Complaint. Therefore, the Commission is simultaneously taking two opposite and inconsistent positions, and to Respondents’ knowledge, has not disclosed its repudiation of the allegations made in the China Valves Complaint either publicly or to the individual still charged in the that litigation. As a matter of public policy, discretion, and fairness, the Commission should be estopped from claiming that Respondents failed to recommend that China Valves make revisions to its 2010 third quarter Form 10-Q.

**CONCLUSION**

For all of the foregoing reasons, Respondents respectfully request that the Commission be estopped from asserting during the Administrative Proceeding that Respondents failed to recommend that China Valves make revisions to its third quarter Form 10-Q, and that all claims in the OIP based on that assertion be dismissed based on the grounds that the Commission's claims are estopped by the doctrine of judicial estoppel due to the Commission's inconsistent position in its action against China Valves.

Dated: April 5, 2016

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## CERTIFICATE OF SERVICE

On April 5, 2016, the foregoing document was sent to the following parties and other persons entitled to notice as follows:

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