

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 MOTION
FOR SUMMARY DISPOSITION AS TO CERTAIN THRESHOLD ISSUES AND
MEMORANDUM IN SUPPORT**

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Respondent Ernst & Young Hua Ming LLP (“EYHM”) respectfully moves for summary disposition as to certain issues and dismissal of the U.S. Securities and Exchange Commission’s (“SEC” or “Commission”) Order Instituting Administrative Proceedings Pursuant to Rule 102(e)(1)(iii) of the Commission’s Rules of Practice (“OIP”).¹

I. PRELIMINARY STATEMENT

For all of the reasons set forth below and in the Memoranda submitted by Respondents Deloitte Touche Tohmatsu CPAs Ltd. (“DTTC”) and PricewaterhouseCoopers Zhong Tian CPAs Limited (“PwC Shanghai”), which EYHM adopts and incorporates herein, EYHM submits that this Rule 102(e) proceeding must be dismissed.

First and foremost, EYHM has not been properly served with the Commission’s OIP. Section 106 of the Sarbanes-Oxley Act, 15 U.S.C. §7216 (“Section 106”), requires that foreign public accounting firms designate a U.S. agent authorized to accept service of two specific categories of documents: (1) Section 106 requests sent by the SEC or the Public Company Accounting Oversight Board (“PCAOB”); and (2) pleadings and papers related to a *judicial* action brought to enforce a Section 106 request. The OIP falls into neither of these categories. EYHM did not consent to service of an OIP via a designated U.S. agent. Nor does the service attempted by the Commission conform to its own Rules of Practice because the method of service attempted by the SEC is prohibited by the laws of the People’s Republic of China (“PRC”). The Commission here simply decided to serve EYHM by mailing the OIP to Ernst & Young LLP (“EYUS”) – the U.S. EY network firm – notwithstanding that the Commission: (1)

¹ The OIP alleges that EYHM “willfully refused” to provide the documents requested by the Commission in its two Section 106 Requests and thereby violated the Sarbanes-Oxley Act, which, it contends, constitutes a violation of the Securities Exchange Act of 1934. EYHM maintains that it is simply inaccurate and unjustifiable to characterize EYHM’s inability to produce documents in response to the Section 106 Requests as a “willful violation” of the securities laws under Rule 102(e) when EYHM has made every effort to produce the requested information to the Commission without violating the laws of the PRC and the specific instructions of the PRC regulators. As described below, through meetings and other communications, EYHM worked diligently with its PRC regulators to address the issues that prevent EYHM from producing these documents and in no way could be found to have “willfully refused” the Commission’s Requests. Should its motion to dismiss be denied, EYHM will address the legal and factual deficiencies of the Commission’s Rule 102(e) claim at the appropriate time.

knew that EYUS was not designated as EYHM's agent to receive the OIP; (2) knew that the U.S. firm was a separate, legal entity from EYHM; and (3) knew it could properly serve EYHM through well-known means of service, but simply did not make that effort. Moreover, because EYUS twice-notified the SEC that it could not accept service of documents (other than those specified in Section 106), the SEC's delivery of the OIP only to EYUS was doubly flawed.

Second, the plain language of Section 106 requires that document requests made pursuant to the statute be enforced only in federal court. And while the SEC characterizes this proceeding as merely seeking to sanction EYHM for failing to produce documents in response to its Section 106 Requests, that claim is misguided, and, in any event, seeks a remedy that is not ripe for consideration. Only if a federal judge enforces a Section 106 request may the SEC institute administrative proceedings pursuant to an OIP. Hence, this administrative proceeding is premature and must be dismissed.

Finally, to the extent the OIP relates to work performed on behalf of Client B, it is invalid. Section 106 is inapplicable to work EYHM performed on behalf of that client because EYHM never issued an audit report for Client B. Section 106(a) specifically states that a "foreign public accounting firm that *prepares or furnishes an audit report . . .* shall be subject to this Act" EYHM did not prepare or furnish any such audit report for Client B.

Accordingly, this action should be dismissed because: (1) the OIP was never properly served on EYHM; (2) this action belongs in a federal court or requires a finding of enforceability by such a court; and (3) at the very least, the matter should be dismissed as it relates to Client B.

II. FACTUAL BACKGROUND

A. Ernst & Young Hua Ming LLP

EYHM is a special general partnership providing audit and other professional services in the PRC.² Headquartered in Beijing, PRC, EYHM has eight offices throughout mainland China

² All of the work papers and other information sought by the Commission's Section 106 Requests are located in the PRC.

and employs over 4200 people, including 3700 accountants. As required by the laws of the PRC, EYHM is registered with the China Securities Regulatory Commission (“CSRC”) and the PRC Ministry of Finance (“MOF”). Between April 1, 2011 and March 31, 2012, EYHM issued twenty-one audit reports for U.S.-issuer companies.

EYHM is a foreign public accounting firm, as defined by Section 106. EYHM first registered with the PCAOB as a foreign public accounting firm on July 8, 2004. At the time of its registration, EYHM did not sign the “Consent to Cooperate with the Board and Statement of Acceptance of Registration Condition, Item 8.1 – Exhibit 8.1,” which provided under section (a) the requirement that a registrant consent “to cooperate and comply with any request for . . . the production of documents” made by the PCAOB. Instead, (and as provided for by Exhibit 99.2 of the application form –Explanation of Conflicting Non-U.S. Law) EYHM submitted a legal opinion from PRC legal counsel which explained in detail that EYHM could not provide the consent requested in Exhibit 8.1 because of conflicting PRC law.³

As the chronology of meetings, letters, and proposals to produce materials detailed below makes clear, EYHM has in fact taken all reasonable steps to cooperate and comply with the Commission’s requests for documents, to the extent permitted by the laws of the PRC, but has been unable to do so despite those efforts, without subjecting itself to severe sanctions for violating applicable PRC laws and the specific instructions of the PRC regulators.

³ More recently, EYHM’s consent under Section 106(b), dated February 28, 2011, provides that EYHM will produce work papers “to the extent permitted by applicable law of the [PRC] . . .” As the Court will observe, in its filings with the PCAOB, EYHM (like other China-based accounting firms) has consistently highlighted the serious difficulties posed by the production of documents outside the PRC.

B. Client C

1. Client C's Background and EYHM's Engagement and Resignation

Client C is a petroleum engineering and technology service provider located in Beijing, PRC.⁴ It purportedly provides enhanced oil recovery services to its customers and conducts its operations primarily in the PRC. EYHM was engaged as Client C's auditor in February 2011 and, in this capacity, performed audit services exclusively in the PRC. EYHM succeeded JBPB & Co. (formerly known as GT Hong Kong) as Client C's auditor. At the time EYHM was engaged, Client C's securities were listed on the NASDAQ Stock Market LLC. EYHM conducted only one audit of Client C's financial statements – on its September 30, 2010 financial statements. EYHM's audit report, dated March 31, 2011, was included in Client C's Form 20-F filing with the Commission on March 31, 2011.

In August 2011, a research and investment firm published an investigative report critical of Client C's operations. Client C responded to the publication by, among other things, asking EYHM to perform certain testing procedures related to the issues raised in the report. In the course of performing the requested work, and after reviewing Client C's records and the claims of the research firm, EYHM determined that Client C likely had engaged in illegal activity. Among other things, Client C's chairman admitted that he had engaged in unauthorized transactions resulting in the transfer of funds from the company to an entity related to him – none of which was reflected in the company's books and records. EYHM brought the matter to the attention of Client C and its audit committee and urged that EYHM be allowed to investigate the issues further. But, the Company failed to provide EYHM with information it requested or authorize it to investigate the issues. Moreover, Client C advised EYHM that the chairman would be retained, notwithstanding EYHM's concerns. As a result, EYHM sent Client C's audit committee and special committee a report pursuant to Section 10A(b)(2) of the Securities

⁴ The Commission filed an injunctive action in Louisiana federal court against Client C and its chairman alleging, among other things, that Client C's chairman misappropriated \$40 million from Client C – an issue identified by EYHM, as described below.

Exchange Act of 1934 (“10A Report”). The 10A Report disclosed EYHM’s problematic findings and concluded that Client C’s responses to EYHM’s findings were impeding the progress and completion of EYHM’s investigation. The 10A Report also was provided to the SEC. EYHM submitted its resignation as Client C’s auditors in a letter dated September 22, 2011.

2. The Commission’s Voluntary Request for Documents Related to Client C and EYHM’s Efforts to Respond to It

On October 5, 2011, the Division of Enforcement Staff (“Staff”) requested that EYHM (and EY Hong Kong) voluntarily produce documents related to its audit work for Client C. The SEC initially directed its request to counsel at EYUS, asking that EYHM retain its documents relating to Client C and stating that a document request would be forthcoming. The Staff asked that EYUS accept the request on behalf of EYHM. Since EYHM and EYUS are separate legal entities and EYUS was not authorized to act for EYHM in connection with such a request, EYUS promptly notified the SEC that its request – and all communications relating to it – must be directed to EYHM and not EYUS. To assist the Commission in its efforts, EYUS provided the Staff with the contact information – telephone number, email and mailing address – for EYHM’s legal counsel.

The Staff thereafter contacted EYHM and sent a voluntary request for documents on October 5, 2011. Pursuant to PRC legal requirements, on October 10, 2011, EYHM met with the CSRC’s Chief Accountant and her staff, as well as members of the MOF’s Supervision and Inspection Bureau, to advise them of the Staff’s request and a related request from the PCAOB, and to seek their direction. The meeting was also attended by representatives of other China-based audit firms, which were consulting with the CSRC on similar issues. During the meeting, the CSRC and MOF representatives unequivocally stated that, in accordance with the relevant PRC laws, EYHM could not provide the requested work papers and related documents to foreign regulators without the consent of the CSRC and MOF. The CSRC representatives also advised EYHM that there was an understanding with the U.S. regulators that work papers and related

documents could only be obtained through the cooperation of the two countries' regulators, to whom all such requests should be directed, and that foreign regulators should not unilaterally punish PRC audit firms for not providing work papers and related documents.

The CSRC memorialized its directives in a letter dated October 26, 2011 ("Letter" or "CSRC Letter"). The Letter reiterated the CSRC's oral directions to EYHM (and other audit firms) regarding production of work papers and related documents outside the PRC and specifically provided the following:

1. Foreign regulators who seek work papers and other archived documents must address those requests to the CSRC;
2. In response to requests to transmit work papers outside of China, EYHM must comply with the 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.

Based on the CSRC's clear directives, on November 11, 2011, EYHM responded to the Staff's October 5, 2011 voluntary request for information, emphasizing that it wished to cooperate with the Commission, but that it could not produce the requested materials without authorization of the CSRC, and possibly other Chinese government agencies. EYHM further advised the Staff that, as a PRC-based audit firm, it was subject to, and must comply with, PRC laws as directed by the CSRC, its local regulator. EYHM identified the applicable PRC laws and regulations and offered to provide more detailed information, if needed. EYHM also stated that it had met with the relevant CSRC and MOF representatives and advised them of the Staff's Request, but had not received authorization from either regulator to produce the requested materials.

After providing its response to the Staff, EYHM made further efforts to respond to the October 5, 2011 voluntary request. On December 8, 2011, EYHM's representative again met with the CSRC's Chief Accountant and her staff regarding the PCAOB's related request for Client C's documents. The CSRC once again made it clear that EYHM could not produce its work papers and related documents directly to foreign regulators (including the Commission) –

whether or not the firm thought that the PRC's laws prohibiting disclosure applied to those documents. The CSRC stated that all foreign regulators' requests must be directed to PRC regulators, which would then determine which documents could be produced to foreign regulators.⁵ At that same meeting, EYHM offered to provide the relevant documents to the CSRC or other regulatory agencies to determine whether the documents, or any subset of them, could be produced.

3. The Section 106 Request to Client C

On February 2, 2012, the Commission served its Section 106 Request for work papers and related documents on EYHM by sending the Request by UPS to EYUS, EYHM's designated agent for receipt of Section 106 requests.⁶ EYUS then forwarded the request to EYHM. As required by PRC law, EYHM promptly informed the CSRC of the Section 106 Request.

In late February 2012, EYHM learned that – in apparent response to the written advice EYHM had provided to the PCAOB (explaining that the CSRC had said that all requests to China-based accounting firms for production of work papers and archived data should be directed to it) – the PCAOB had contacted the CSRC 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 the Division.” As a result of the PCAOB's request to the CSRC and the Division's Section 106 Request, EYHM asked to meet with the CSRC and the MOF to facilitate the production of documents. To that end, EYHM (and representatives from other China-based audit firms, which had received similar requests from the U.S. regulators) met with representatives from the MOF's Supervision and Inspection Bureau, Accounting Supervision Department, and Legal Department on February

⁵ The position stated by the CSRC was reiterated by the divisional director of the MOF's Supervision and Investigation Bureau, with whom EYHM met on December 9, 2011.

⁶ The Commission's Section 106 Requests to Clients B and C were accompanied by a Form 1662. That form was also provided to the other Respondents together with the Section 106 requests served on them.

24, 2012. The message communicated by the CSRC and MOF regulators at this meeting did not vary from that delivered during earlier meetings: neither EYHM nor the other firms could provide work papers and related documents to foreign regulators, and those regulators should obtain work papers and related documents through regulatory cooperation. EYHM continued meeting with PRC regulators during the months of April and May 2012. Time and again, however, EYHM was told that the Commission's requests and any responses thereto must be made through PRC regulators and not directly to the audit firms.

C. Client B

1. Client B's Background and EYHM's Engagement and Termination

Client B is a public company registered in Delaware with its headquarters in Beijing, PRC.⁷ Client B, a holding company operating through three China-based, wholly-owned subsidiaries, claims to be a leading developer, manufacturer and distributor of organic compound fertilizers in the PRC. EYHM was engaged by Client B in November 2010 and succeeded Crowe Horwath LLP as auditor. EYHM never issued an audit report on Client B's financial statements during its time as Client B's auditor.

In February 2011, an investment research report called into question aspects of Client B's business. In response to the report, Client B asked EYHM to perform certain work and audit procedures. While performing the requested work, EYHM identified, among other things, potential violations of the U.S. securities laws. EYHM ceased its audit work on behalf of Client B and promptly brought its findings to the attention of Client B's audit committee. EYHM requested that the audit committee act quickly and take appropriate remedial action. Client B initially assured EYHM that a special investigation committee of the board would be formed to

⁷ The Commission instituted administrative proceedings against Client B on October 17, 2012 for failing to file current financial information in violation of Section 13(a) of the Exchange Act and Rules thereunder. In anticipation of the institution of the administrative proceedings, Client B submitted an Offer of Settlement, which the Commission accepted, and Client B was ordered to cease and desist from further violations and its registration of securities was revoked.

address the issues identified by EYHM, but Client B's related March 13, 2011 press release failed to disclose the fact that EYHM had identified issues during its audit.

EYHM promptly informed Client B and its outside counsel that it would resign as auditors unless Client B issued a corrected press release. Instead, Client B terminated EYHM the following day and issued a press release stating the termination was due to independence concerns stemming from "Sox 404 work." EYHM had not been given prior notice of the termination, nor did EYHM believe that its termination was warranted. As a result of these events, EYHM concluded that, pursuant to its professional obligations, it was required to send a 10A Report to Client B's board of directors stating its belief that Client B's audit committee had failed to make the company's management take appropriate remedial action with respect to the audit issues raised by EYHM. EYHM sent its 10A Report to Client B on March 15, 2011, and Client B filed an 8-K regarding EYHM's dismissal on March 18, 2011. EYHM's 10A Report was also sent to the SEC.

2. The Commission's Voluntary Request for Documents Related to Client B and EYHM's Efforts to Respond to It

In June 2011, EYUS was contacted by a Staff representative who indicated that they were seeking work papers and other information related to work EYHM had done for Client B. As it subsequently did with Client C, EYUS informed the Staff that they needed to contact EYHM's representatives directly to address the Staff's request. The Staff thereafter contacted the appropriate EYHM representatives. On June 30, 2011, EYHM received a voluntary request from the Staff for documents relating to audit work performed for Client B.

In response to that voluntary request, EYHM produced certain categories of documents and other information to the Staff on July 29, 2011. At the same time, EYHM advised the Staff that other categories of documents, such as work papers and related documents, could not be produced because PRC law prohibited the production of those documents without authorization from PRC regulators. EYHM also provided the Staff with a legal memorandum that addressed

the specific PRC laws applicable to the documents requested by the Division and the reasons why PRC laws precluded the production of those documents.

As required by PRC law, EYHM notified the CSRC of the Division's June 30, 2011 voluntary request for Client B's work papers and related documents. The voluntary request to Client B was addressed at the meeting between EYHM (and other China-based audit firms) and representatives of the CSRC and MOF discussed above in Section II. B. 2, on October 10, 2011.

As discussed above, this was the first of many meetings between EYHM and the CSRC and the MOF concerning requests by either the SEC or PCAOB for work papers and related documents. The position of the PRC regulators has never changed, and their instructions to EYHM never varied: EYHM may not produce documents directly to the Commission or its Staff (or the PCAOB) without those regulators' prior approval, and foreign regulators may obtain work papers and related documents only through requests directed to the CSRC.

3. The Section 106 Request to Client B

On May 1, 2012, EYUS – EYHM's designated agent for receiving Section 106 requests in the United States – was served by mail with the Commission's April 26, 2012 Section 106 Request to EYHM. The Section 106 Request sought EYHM's work papers and related documents for the Client B engagement. Upon receiving the Commission's Section 106 Request from EYUS, EYHM arranged to meet again with the CSRC and the MOF to discuss the request. The message EYHM received at the May 10, 2012 meeting and those that followed was consistent with that delivered during its meetings related to Client C. Thus, despite its efforts, and as of this date, EYHM has not been authorized to produce to either the SEC or the PCAOB its work papers or related documents for work performed for Clients B or C.

D. Order Instituting Administrative Proceedings

On December 3, 2012, the Commission issued the OIP against EYHM. The OIP was not served on EYHM, but was sent via registered U.S. mail to EYUS. The letter accompanying the OIP was addressed to counsel at EYUS and advised EYUS that, among other things, should EYHM fail to answer or appear in response to the OIP, it could be found in default and barred

from practicing before the Commission. On December 7, 2012, EYUS notified the Office of the Secretary of the SEC in writing that it was in receipt of the OIP, but advised that EYHM “is a separate legal entity from [the U.S. Member Firm]” and directed the Staff to contact counsel for EYHM.

EYHM answered the OIP on January 7, 2013, reserving its defenses including failure of service and lack of proper jurisdiction, and now moves to dismiss the OIP consistent with the schedule set at the January 9, 2013 pre-hearing conference.

III. ARGUMENT

A. THE SECTION 106 REQUESTS CANNOT BE ENFORCED UNTIL THE OIP IS PROPERLY SERVED

EYHM adopts and incorporates by reference the arguments set forth in DTTC’s motion for summary disposition and dismissal of the OIP.

B. THE OIP MUST BE DISMISSED BECAUSE IT IS PREMISED ON SECTION 106 REQUESTS THAT HAVE NOT BEEN ENFORCED IN FEDERAL COURT

EYHM adopts and incorporates by reference the arguments set forth in DTTC’s motion for summary disposition and dismissal of the OIP.

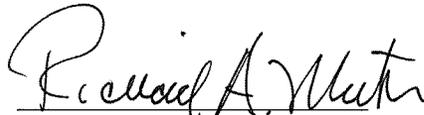
C. THE OIP MUST BE DISMISSED AS TO CLIENT B BECAUSE SECTION 106 DOES NOT APPLY SINCE EYHM DID NOT PREPARE OR FURNISH AN AUDIT REPORT FOR CLIENT B

EYHM adopts and incorporates by reference the arguments set forth in PwC Shanghai’s motion for summary disposition and dismissal of the OIP.

IV. CONCLUSION

Based on the foregoing, EYHM respectfully submits that the SEC's OIP be dismissed.

Dated February 1, 2013



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