

UNITED STATES OF AMERICA
Before the
SECURITIES AND EXCHANGE COMMISSION



ADMINISTRATIVE PROCEEDING
File No. 3-15116

In the Matter of

BDO China Dahua CPA Co., Ltd.;
Ernst & Young Hua Ming LLP;
KPMG Huazhen (Special General Partnership);
Deloitte Touche Thomatsu Certified
Public Accountants Ltd.;
PricewaterhouseCoopers Thong Tian
CPAs Limited

Respondents

RESPONDENT DAHUA CPA CO., LTD'S PRE-HEARING BRIEF

Date: June 24, 2013

Deborah R. Meshulam
Grayson D. Stratton
DLA PIPER LLP (US)
500 Eighth Street, N.W.
Washington, DC 20004
Tel: (202) 799-4000
Fax: (202) 799-5000

Counsel for Dahua CPA Co., Ltd.

TABLE OF CONTENTS

	<u>Page</u>
I. PRELIMINARY STATEMENT	1
II. BACKGROUND	2
A. Dahua	2
B. Dahua’s Engagement by Client A.....	3
C. China’s Regulatory Framework.....	4
D. Dahua’s Disclosure of Chinese Legal Restrictions in its PCAOB Registration	6
E. The Staff’s Requests for Client A Workpapers and Dahua’s Efforts to Cooperate	7
F. The OIP	9
G. Recent Progress in Discussions Between the SEC and CSRC	9
III. ARGUMENT	10
A. Dahua’s Inability to Produce Audit Work Papers is not a “Willful Refusal” to Comply with Section 106	10
B. The Division Cannot PROVE that Respondents Willfully Refused to Comply with the Section 106 Requests	10
C. The SEC’s Attempt to Sanction Respondents is an Arbitrary and Capricious Departure From Prior Policy	11
D. Sanctions in this Case Are Unwarranted	11
IV. CONCLUSION.....	13

TABLE OF AUTHORITIES

	Page(s)
CASES	
<i>In re Sealed Case</i> , 825 F.2d 494 (D.C. Cir. 1987).....	12
<i>Societe Internationale v. Rogers</i> , 357 U.S. 197 (1958).....	10
<i>Steadman v. SEC</i> , 603 F.2d 1126 (5th Cir. 1979), <i>aff'd</i> , 450 U.S. 91 (1981).....	11
 STATUTES	
15 U.S.C. 7216(f).....	12
Pub. L. No. 111-203, 124 Stat. 1376 (2010).....	12
 OTHER AUTHORITIES	
17 C.F.R. § 201.222.....	1
68 Fed. Reg. 43,242 (July 16, 2003).....	6
PCAOB Rule 1001(i)(ii).....	3
PCAOB Rule 2105.....	6
PCAOB Rule 2207.....	6
<i>Provisions on Strengthening Confidentiality and Archives Administration of Overseas Issuance and Listing of Securities</i> (" <u>Regulation 29</u> ").....	4

Respondent Dahua CPA Co., Ltd. (formerly BDO China Dahua CPA Co., Ltd.) (“Dahua”) respectfully submits this Prehearing Brief in accordance with Rule 222 of the Rules of Practice of the United States Securities and Exchange Commission (“SEC” or “Commission”), 17 C.F.R. § 201.222, and this Court’s June 10, 2013 Order on Joint Motion to Amend Hearing and Prehearing Schedules.¹ Dahua adopts and incorporates by reference the prehearing brief submitted by Respondent Deloitte Touche Tohmatsu Certified Public Accountants Ltd. (“DTTC”), the prehearing brief related to remedies submitted by Respondent KPMG Huazhen (Special General Partnership) (“KPMG Huazhen”), and the prehearing briefs submitted by the other Respondents in this proceeding.

I.
PRELIMINARY STATEMENT

This is an unprecedented case. The SEC, a law enforcement agency, is seeking to have this Court sanction Dahua and the other Respondents because they have complied with the laws of their home country.

Like the other Respondents in this proceeding, Dahua is caught between the competing interests and regulations of the United States and China. As a Chinese accounting firm, Dahua is prohibited by Chinese law from producing its audit work papers directly to the SEC. Chinese law requires instead that, upon a proper request from a foreign authority, Dahua must notify Chinese regulators of the request and those Chinese government authorities alone will determine whether the documents can and will be produced in accordance with Chinese law.

Aware of these legal restrictions, the Commission sent Dahua a request for audit work papers pursuant to Section 106 of the Sarbanes-Oxley Act of 2002 (“SOX 106”) after first

¹ Dahua reserves all rights with respect to the issues raised in its previously filed Motion to Dismiss regarding sufficiency of service and whether an enforceability ruling by a federal court under Section 106 is required prior to the institution of this action.

seeking the documents through a voluntary request. Respondents Exhibit (“R. Ex.”) 48. Although Dahua promptly sought permission (for both the voluntary and SOX 106 requests) from the appropriate Chinese authorities to provide the documents to the Commission staff (“Staff”), those authorities would not provide permission. Dahua advised the Staff that Chinese law prohibited Dahua from sending its work papers directly to the SEC and that it could not, therefore, provide the documents. Dahua asked the SEC to work with Chinese regulators so that Dahua could provide the requested documents.

Rather than work with the Chinese regulators through long-established procedures, the SEC decided to initiate this proceeding seeking sanctions for Dahua’s claimed “willful refusal” to provide the documents. The Commission’s position is apparently that, rather than working through previously established bilateral approaches with the China Securities Regulatory Commission (“CSRC”) and other Chinese authorities, it may seek sanctions in an administrative proceeding against Dahua and the other Respondents even when their compliance with the Staff’s requests would require Respondents to violate their home country laws.

The OIP’s allegations that Dahua “willfully refused” to provide the documents sought by the Staff in its SOX 106 request and, therefore, violated the Securities Exchange Act of 1934 are baseless. Dahua has made every effort to provide the requested documents while complying with PRC law. As summarized in this memorandum, Dahua more than once attempted to persuade the Chinese regulators to allow it to respond to the Staff’s information request. Such conduct is the antithesis of “willful refusal.”

II. BACKGROUND

A. Dahua

Dahua is one of the largest accounting firms in China. It employs approximately 2,680 people, including 870 accountants, in 16 offices throughout China. Dahua provides a range of services to its clients, including audit and tax services. Previously, Dahua was associated with the BDO network of accounting firms but, as of May 1, 2013, is no longer affiliated with BDO. Dahua is a “foreign public accounting firm” within the meaning of SOX 106. Dahua is licensed to perform work in China by China’s Ministry of Finance (“MOF”) and the CSRC.²

Since September 2005, Dahua has been registered with the Public Company Accounting Oversight Board (“PCAOB”) because certain of its audit clients are “issuers” as that term is defined by PCAOB Rule 1001(i)(ii). Significantly, the PCAOB accepted Dahua’s application for registration as a public accounting firm in 2005, after Dahua advised it that the firm might not be able to produce audit work papers due to Chinese legal restrictions. *See* R. Ex. 40; Section II.C below.

B. Dahua’s Engagement by Client A

On October 29, 2010, Client A engaged Dahua as the company’s independent auditor. Client A processes, distributes and sells processed seafood-based snack foods, as well as fresh and frozen marine catch and ices throughout China. It’s algae-based soft drinks are sold to retail food stores, the hospitality industry, restaurants, and food supply dealers and distributors in China.

² As discussed in Section II.B, the CSRC is the primary regulator of the Chinese securities market. It has jurisdiction over companies listed in China and those incorporated in China and listed overseas. The MOF is the primary regulator of Chinese accounting firms.

Client A's business involves access to Chinese state technological and biological research. One of Client A's primary subsidiaries has entered into a memorandum of understanding for collaboration with a national university under the direct jurisdiction of the Ministry of Education of the People's Republic of China. The collaboration allows Client A to share the national university's technical expertise, and to acquire new technical knowledge and processing techniques. In turn, Client A serves as a research base for the research and development work of this national university. The national university also provides technical and training support in the development of production techniques upon request. The research and development activities are conducted at Client A's production facilities.

Dahua audited Client A's financial statements for the years ended December 31, 2010 through December 31, 2012. It also performed interim reviews of Client A's quarterly financial statements during this period. As a result of Dahua's disassociation from BDO, it was dismissed as Client A's auditor as of April 30, 2013.

C. China's Regulatory Framework

As a Chinese audit firm, Dahua is registered with and regulated by the CSRC and the MOF. The CSRC is the primary regulator of the Chinese securities market. It has jurisdiction over companies listed in China and those incorporated in China and listed overseas. The MOF is the primary regulator of Chinese accounting firms.

Chinese law imposes strict controls on the disclosure of sensitive materials both domestically in China and abroad. Among other relevant laws, Dahua is subject to the Securities Law of the People's Republic of China, the Law of the People's Republic of China on Certified Public Accountants, the Law of the People's Republic of China on Guarding State Secrets, and the Archives Law of the People's Republic of China. *See* Expert Report of Professor Xin Tang.

In addition, China's *Provisions on Strengthening Confidentiality and Archives Administration of Overseas Issuance and Listing of Securities* ("Regulation 29"), promulgated by the CSRC and other Chinese regulators, requires Dahua to comply with strict approval and filing procedures when providing documents and work papers to foreign regulators. Under Regulation 29, audit firm "work papers," "shall not be carried or shipped overseas, or delivered to overseas institutions or individuals" without express prior approval from Chinese authorities, including the CSRC. R. Ex. 296 (Regulation 29) at Article 6. Chinese audit firms must also advise the CSRC of any requests for documents by foreign regulators. *Id.* at Article 8.

Sanctions for violating Regulation 29 are severe, including suspension of the offending accounting firm from the accounting profession, and dissolution of the firm, and can result in imprisonment of Dahua partners if the documents produced without authorization are determined by Chinese authorities to contain information protected from disclosure under Chinese law. China has previously imprisoned professionals for violating its state secrets laws through the dissemination of apparently publicly available information. *See e.g., The Uncurious Case of Xue Feng's Jail Sentence*, FORBES.COM (July 7, 2010), <http://www.forbes.com/2010/07/07/xue-feng-stern-hu-state-secrets-opinions-contributors-john-lee.html> (business executive jailed for using Chinese steel industry information received at a conference). In addition, the law of China regarding certified public accountants mandates that Dahua keep all "commercial secrets" confidential, including documents and information relating to the business of audit clients.

In October 2011, the CSRC stated its views on these issues in a letter to "Accounting Firms Concerned." The letter contained the following directions to all Chinese CPA firms.

The provision of audit working papers and other audit file documents abroad by accounting firms has to comply with the *Securities Law of the People's Republic of China*, the *Law of the People's Republic of China on Certified Public Accountants*, the

Law of the People's Republic of China on Guarding State Secrets, the Archives Law of the People's Republic of China. These relevant laws, regulations, rules and regulations must be followed, together with the corresponding legal procedures.

In the event that foreign regulatory agencies require relevant audit working papers and other file documents in the performance of their statutory responsibilities, they should resolve such matters through joint consultations using regulatory cooperation mechanisms with the Chinese regulatory agencies.

Accounting firms must adhere to the relevant Chinese laws, regulations, rules and systems, and properly respond to the relevant matters. Any breach of the 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.

R. Ex. 20. The CRSC letter confirms that Chinese authorities view the unauthorized production of the documents and work papers to the SEC to be a violation of Chinese law.

D. Dahua's Disclosure of Chinese Legal Restrictions in its PCAOB Registration

The SEC is aware of the legal restrictions on the production of documents by Chinese accounting firms and has been for many years. In 2003, the PCAOB adopted and the SEC approved rules that expressly permitted Dahua and other Chinese accounting firms to register with the PCAOB as public accounting firms despite their inability to produce certain documents under Chinese law. *See* PCAOB Rules 2105, 2207; Order Approving Proposed Rules Relating to Registration System, SEC Rel. No. 34-48180, File No. PCAOB-2003-03, 68 Fed. Reg. 43,242 (July 16, 2003). Dahua fully disclosed the restrictions imposed by Chinese law in its Form 1 registration application submitted to the PCAOB in September 2005. Specifically, Dahua stated:

[A]lthough there are applicable laws that prevent our firm from providing the full cooperation required by Item 8.1 of Form 1 [requiring production of documents and witnesses], it may be possible for our firm, in certain instances, to cooperate with the PCAOB without violating any such applicable laws. Accordingly, we have been unable to provide the Item 8.1 consents in their current form in Form 1 but hereby agree to take all reasonable

steps to cooperate in and comply with any request for testimony or the production of documents made by the PCAOB to the fullest extent permitted by applicable laws.

R. Ex. 40 (Dahua Form 1) at Exhibit 99.2. In conjunction with the representation above, Dahua submitted a legal opinion to the PCAOB pursuant to PCAOB Rule 2105 stating:

The requirement that the applicant cooperate in and comply with any request for testimony or the production of documents made by PCAOB under Item 8.1(a), will violate certain provisions of PRC Laws and Regulations which prohibit disclosure of documents obtained during professional work by a certified public accountant (“CPA”), including audit workpapers

Id. at Exhibit 99.2 attachment (law firm memorandum). Dahua’s application for registration was accepted with these caveats and without the firm having provided Item 8.1 consents.

E. The Staff Requests for Client A Workpapers and Dahua’s Efforts to Cooperate

On May 19, 2011, in connection with an investigation of Client A, the Staff sent a request for the voluntary production of certain audit work papers to Dahua through BDO USA. The documents and audit work papers relating to Client A were prepared in China and are stored in China. The Staff requested that Dahua produce documents directly to the Commission.

Upon receipt of the document request, in compliance with Chinese law, Dahua contacted the CSRC and then the MOF to request permission to provide the Staff with the requested documents. Dahua was told that it could not provide the information to the Staff. Dahua promptly advised the Staff of the MOF and CSRC position and requested that the Staff work with the MOF and the CSRC to obtain the requested documents.

There is no evidence that the SEC has asked the CSRC or other Chinese authorities for assistance in obtaining the audit-related files of Dahua with respect to Client

On October 10, 2011, Dahua (together with the other Respondents in this proceeding, who were facing the same issue) was directed to attend a meeting with the CSRC's Chief Accountant and other representatives of the CSRC and MOF. Among other things, the CSRC and MOF representatives advised Dahua (and the other firms) that it was not allowed to produce its audit workpapers directly to foreign regulators such as the SEC. The CSRC and MOF representatives also advised that the proper way to respond to requests such as those from the Staff was to refer the request to Chinese regulators and for the foreign regulator to work with Chinese authorities to gain access to the work papers. The CSRC and MOF representatives stated that those who provided work papers to overseas regulators without the consent of the CSRC and MOF would face punishment for violating Chinese law. It was after this meeting that the CSRC issued its letter to "Accounting Firms Concerned" discussed in Section II.C above.

On February 1, 2012, pursuant to SOX 106 and Section 929J of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the Staff formally sought production of Dahua's work papers related to its audit work and interim reviews performed for Client A for the fiscal year ending December 31, 2010. Following receipt of the SOX 106 request, Dahua again sought permission from Chinese regulators to provide the work papers to the Staff. Again, the Chinese regulators declined to give Dahua permission to provide the information.

In its April 2, 2012, response to the Staff, Dahua reiterated that it wanted to provide the information but could not send it directly to the Staff because "such production will violate Chinese law and expose [Dahua] to serious civil and criminal liability." R. Ex. 50. Dahua advised the Staff that it had sought approval from the CSRC and the MOF, and that each agency had declined to approve production of the documents to the SEC. Dahua asked that the SEC not

require it to produce documents in violation of Chinese laws which could lead to the imprisonment of those involved in the production. *Id.*

The Staff's response was to send a Wells Notice on May 3, 2012, stating that the Staff intended to recommend that the SEC initiate administrative proceedings pursuant to Rule 102(e) against Dahua in the U.S. for its failure to produce audit work papers and related documents in response to the Staff's February 12, 2012 demand under SOX 106, as amended.

On May 11, 2012, Dahua again asked the CSRC and MOF to approve production of the documents to the Commission staff. R. Ex. 52. Dahua's letter advised the CSRC and MOF that Dahua believed the firm's audit of Client A's financial statements was conducted "in accordance with the U.S. Auditing Standards," and "the audited financial statements accurately reflect the company's financial conditions and operational result[s]." Dahua further stated: "We would like to provide our audit to the SEC so that it can see that our audit was properly done." The letter concluded: "In this case, should we provide the work papers to the SEC? If not, what kinds of measures we should take to reply to the SEC Wells Notice? Will the Ministry of Finance and CSRC communicate with the SEC regarding to this issue?" [*sic*] *Id.* Similarly, in a letter to the MOF and CSRC dated June 25, 2012, Dahua reported its correspondence with the SEC and ended its letter with the following plea: "We urge the Ministry of Finance and the Securities Regulatory Commission to provide directions or advice on our approach to the matter." R. Ex. 54. As of the date of this filing, the CSRC and MOF have not granted approval for the production of Dahua's audit work papers and related documents.

F. The OIP

On December 3, 2012, the SEC initiated these administrative proceedings pursuant to Rule 102(e) of the Commission's Rules of Practice against Dahua and the other Respondent

accounting firms, seeking sanctions based on an alleged willful refusal to produce audit work papers related to Client A, among others, in response to the Staff's demands under SOX 106.

G. Recent Progress in Discussions Between the SEC and CSRC

As detailed in the pre-hearing brief of PricewaterhouseCoopers Thong Tian CPAs Ltd., which is incorporated and referenced herein, recently there have been signs of diplomatic progress between U.S. and Chinese regulators. Most recently, that progress has led to a May 7, 2013 memorandum of understanding between the PCAOB, the CSRC and MOF. That memorandum of understanding establishes a framework for the exchange of audit materials between the parties in furtherance of their investigative duties. R. Ex. 274.

**III.
ARGUMENT**

A. Dahua's Inability to Produce Audit Work Papers is not a "Willful Refusal" to Comply with Section 106

Dahua's inability to produce work papers for Client A is not a "willful refusal" under Section 106. "Willful refusal" under SOX 106 requires more than an inability to produce documents due to foreign law. *See Societe Internationale v. Rogers*, 357 U.S. 197, 208 (1958) (contrasting the inability of a party to produce bank records due to Swiss law with "willful" conduct). In further support of this argument, Dahua respectfully adopts and incorporates by reference the arguments set forth in each of the pretrial briefs, supporting memoranda, exhibits and supporting declarations of DTTC and each of the other Respondents.

B. The Division Cannot PROVE that Respondents Willfully Refused to Comply with the Section 106 Requests

Dahua's efforts to comply with Chinese law and to provide its work papers to the Staff demonstrates that it has acted in good faith. Compliance with legal requirements should not form the basis for a finding of "willful refusal." In further support of this argument, Dahua adopts and

incorporates by reference the arguments set forth in each of the pretrial briefs, supporting memoranda, exhibits and supporting declarations of DTTC, and each of the other Respondents.

C. The SEC's Attempt to Sanction Respondents is an Arbitrary and Capricious Departure From Prior Policy

Dahua adopts and incorporates by reference the arguments set forth in each of the pretrial briefs, supporting memoranda, exhibits and supporting declarations of KPMG Huazhen, DTTC, and each of the other Respondents.

D. Sanctions in this Case Are Unwarranted

The claim against Dahua has no merit. If this Court were to disagree, however, sanctions against Dahua are inappropriate for the reasons stated in the pre-hearing brief of KPMG Huazhen regarding remedies and sanctions, and in the pre-hearing briefs of the other Respondents, Dahua adopts and incorporates by reference the arguments made in those submissions. As detailed in those briefs, the factors set forth in *Steadman v. SEC*, 603 F.2d 1126 (5th Cir. 1979), *aff'd*, 450 U.S. 91 (1981), balance in favor of Dahua and against the imposition of any sanction.

Dahua has acted in good faith. As set forth in Section II above, Dahua tried on multiple occasions to obtain authorization to produce the requested documents to the SEC. In doing so, Dahua said, “[w]e would like to provide our audit work papers to the SEC so that it can see that our audit was properly done.” Unfortunately, the Chinese regulators have denied Dahua’s requests.

The facts of this case support the conclusion that this Court should not sanction Dahua. This is particularly so where the information originated in China and where Dahua is a foreign entity. Courts are reluctant to even enforce requests for documents in such

circumstances. *E.g., In re Sealed Case*, 825 F.2d 494, 498 (D.C. Cir. 1987) (“it causes us considerable discomfort to think that a court of law should order a violation of law, particularly on the territory of the sovereign whose law is in question.”). It is inconsistent with the SEC’s mandate as a law enforcement agency to sanction Dahua for its compliance with the law of its home country, which has a sovereign and regulatory interest in Dahua’s conduct at least as strong as that of the SEC.

Dahua is caught in the middle of conflicting international laws. Dahua would pay a heavy price to comply with the SEC’s request. If Dahua were to produce the requested documents to the SEC without first obtaining authorization from the CSRC and other state authorities, it would violate Chinese law and face severe penalties under Chinese law, including imprisonment of those involved in the production. Practically speaking, Dahua has no choice in this matter. It must comply with Chinese law. Sanctioning Dahua under such circumstances serves no remedial purpose and would be unduly severe.

Dahua remains willing to provide the work papers sought by the SEC consistent with all legal requirements to which it is subject. It is willing to participate in a cross-border dialogue between the SEC and the CSRC and MOF if its participation will facilitate a resolution to this case. If an agreement is reached between the relevant agencies that will permit Dahua to produce the documents while remaining compliant with all applicable laws and regulations, then Dahua will produce the documents requested by the SEC without hesitation and without delay.

Congress has provided the Commission with an alternate means of requesting these documents, and at the same time, has provided Dahua with a safe harbor from strict compliance with SOX 106 should the SEC permit its application in this case. Dodd-Frank 929J provides for the following “alternate means” of production: “the staff of the Commission may allow a

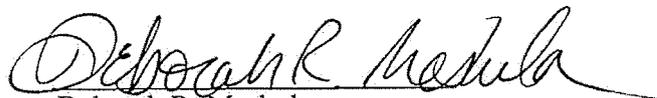
foreign public accounting firm . . . to meet production obligations under this section through alternate means, such as through foreign counterparts of the Commission.” Pub. L. No. 111-203, 124 Stat. 1376 (2010); 15 U.S.C. 7216(f). Dahua respectfully requests that the Court encourage the SEC to commence a direct dialogue with Chinese authorities regarding the Client A audit work papers and permit Dahua to produce documents pursuant to that process rather than impose sanctions against Dahua and the other Respondents in this proceeding.

**IV.
CONCLUSION**

For the foregoing reasons, the SEC Division of Enforcement is unable to prove that Respondents willfully refused to comply with the Section 106 Requests, and in any event, an attempt to sanction Respondents in these circumstances is unwarranted and impermissibly arbitrary and capricious.

Dated: June 24, 2013

Respectfully submitted,



Deborah R. Meshulam
Grayson D. Stratton
DLA Piper LLP (US)
500 8th Street, N.W.
Washington, DC 20004
Tel: (202) 799-4000
Fax: (202) 799-5000

Counsel for Dahua CPA Co., Ltd.