STITES & HARBISON PLLC

ATTORNEYS

SunTrust Center
424 Church Street
Suite 1800
Nashville, TN 37219-2376
(615) 244-5200
(615) 782-2371 FAX
www.stites.com

January 8, 2003

B. Riney Green
(615) 782-2241
riney.green@stites.com

Hon. Harvey L. Pitt
Chairman
Securities & Exchange Commission
450 Fifth Street, NW
Washington, DC 20549

Alan L. Beller, Esq.
Director, Corporate Finance Division
and Senior Counselor to the Commission
Securities & Exchange Commission
450 Fifth Street N.W.
Washington, DC 20549

Re: Inadequate Disclosure of Risks to American Investors of Unreliable Chinese Government Economic Data, of Predicted Political Instability in China, and of Prior Chinese Government Debt Repudiation

Gentlemen:

On behalf of our client the American Bondholders Foundation[1], we request that the Securities and Exchange Commission carefully examine whether foreign issuers based in China are adequately disclosing investment risks to current and prospective American owners of Chinese corporate or government stocks and bonds.

In particular, we request that the Commission evaluate whether Chinese corporate issuers who are presently, or who will become, subject to the Commission's disclosure requirements under the 1933 Act or the 1934 Exchange Act, especially those issuers with a controlling or large bloc of equity securities owned directly or indirectly by the Chinese Government (the People's Republic of China – PRC), are properly disclosing the known risks posed by (1) the credible allegations that official Chinese Government economic statistics are unreliable and misleading; (2) the adverse consequences of increasing and predicted political instability of the Chinese government; and (3) the official Chinese Government position of the repudiation of Chinese sovereign debts issued by established predecessor Chinese governments.

[1] The American Bondholders Foundation is an organization of U.S. individual owners of Chinese Government full faith and credit bonds issued prior to 1949 that seek to require China to honor its sovereign and contractual obligations to bondholders. Although China in 1987 made payments to British holders of pre- 1949 Chinese government bonds to settle the claims of British bondholders, China has failed to refused to make any payments to American bondholders of similar Chinese government bonds.

We believe that current and future American investors need the protection which the Commission can provide by ensuring that all Chinese corporate and government issuers make full and fair disclosure to the investing American public of the unique risks associated with investing in stocks or bonds of Chinese companies or of the Chinese government.

1. **Misleading Chinese Government Economic Data.**

In its recent (October 31, 2002) quarterly filing with the Commission on Form 6-K, the China Petroleum & Chemical Corporation (called Sinopec) (NYSE/symbol:SPN) stated:

> "In the first three quarters of 2002, the PRC economy continued to maintain rapid growth, with a GDP growth rate of 7.9%. Benefiting from the above, there was a stable growth in the domestic demand for refined oil and petrochemical products...." (emphasis added).
>
> "The Company believes that in the fourth quarter of 2002 .... China's economy will maintain a steady and healthy growth, which will create more demand for petrochemical products in China and a positive market environment for the business of the Company." (emphasis added).

Sinopec is basing its projections of future profitability and stockholder value on the reliability of the Chinese government's rosy economic data. According to a December 16, 2002 report included in the New Republic magazine, the official Chinese government claims of 7%- 10% annual growth during each of the last 20 years "do not add up".[2] The article further reports that the actual growth rate during the 1998-2001 period was closer to 4% and that "China has been plagued by deflation, rising unemployment and declining energy use."[3] The article goes on to state that China's national economic statistics are subject to "political meddling" and "corruption"[4], that more than two-thirds of the biggest Chinese companies "falsify their accounting"[5], that China's "economy is becoming less efficient and competitive, that the country is "without a decent legal system", and that its banking system could be insolvent by 2008. The author concludes that "Ultimately, China's economic façade probably will crack. And, when it does, the consequences may be disastrous." [6]

The Commission has correctly focused attention during the last year on the accuracy, completeness and transparency of American companies' financial statements and their

---

[2] "Asia Minor, Is China's Economic Boom a Myth", by Joshua Kurlantzick, The New Republic, December 16,2002, page 20.
[3] Id.
[4] Id., pages 20 and 24
[5] Id., page 24.
[6] Id., page 25.

management's analysis. We believe the same level of scrutiny should be applied to those Chinese based companies whose shares are listed on U.S. exchanges or that otherwise desire to access the American capital markets. Otherwise, American investors risk significant losses as a result of their investment in Chinese companies based on their misplaced reliance on information which, if recently published reports are accurate, is materially misleading.

We urge the Commission to confer with U.S. intelligence and Treasury officials in order to access the resources available to make an independent analysis of the statements on the performance and stability of China's economy contained in filings made with the Commission and relied upon by the American investing public.

According to the July 2002 report of the U.S. – China Security Review Commission (established and appointed by the U.S. Congress), "Chinese firms raising capital or otherwise trading their securities in the U.S. markets have predominately been major [majority] state-owned enterprises, some of which have ties to China's military, defense industry, or intelligence services." As a result, since the Chinese PRC government directly or indirectly controls a majority of the ownership of most of the Chinese companies which are listed on U.S. exchanges and are subject to the periodic filing of reports with the Commission, it is doubtful that most such Chinese companies have the independence needed to vigorously challenge the accuracy of the Chinese government's official economic data.

The U.S. – China Security Review Commission recommended in July 2002 that the Securities and Exchange Commission more carefully scrutinize the disclosure in the United States of certain foreign issuers, including certain Chinese corporate issuers, to minimize concerns about U.S. national security risks posed by the activities of certain foreign companies"[7]. Similarly, the SEC should carefully scrutinize the accuracy of statements and implied optimistic forecasts contained in SEC filings of Chinese issuers whenever such statements and forecasts are based on the questionable economic data of the Chinese government.

<u>2. Political Instability of Chinese Government.</u>

Experts and political analysts are expressing increasing doubt about the ability of the present Communist Party controlled Chinese government to either reform or survive. This looming political crisis poses real financial risks to Americans investing in Chinese based companies and in debt securities of the Chinese government. The Chinese Government (through sovereign bond offerings) and Chinese state-owned and other enterprises have raised significant funds in overseas capital

---

[7] Chapter 6 of the July 2002 Report to Congress of the U.S. –China Review Commission – The National Security Implications of the Economic Relationship Between the United States and China – "China's Presence in U.S. Capital Markets"

markets in recent years, including the U.S. capital markets.[8] Accordingly, the American Bondholders Foundation urges the Securities and Exchange Commission to (1) carefully review each registration statement and periodic report filed by a Chinese government or corporate issuer and (2) require the conspicuous inclusion of adequate disclosure that will alert the investing American public to the material risks posed by this incipient instability and volatility.

In a recent edition of Foreign Affairs one prominent analyst of Chinese political affairs noted the increasing dysfunction of the Chinese government and the associated threat to economic and political stability.

> China's governance deficits are likely to continue to grow and threaten the sustainability of its economic development. The slow-brewing crisis of governance may not cause an imminent collapse of the regime, but the accumulation of severe strains on the political system will eventually weigh down China's economic modernization as poor governance makes trade and investment more costly and more risky. The current economic dynamism may soon fade as long-term stagnation sets in.
>
> Such a prospect raises questions about some prevailing assumptions about China. ...[t]he international business community, in its enthusiasm for the Chinese market, has greatly discounted the risks embedded in the country's political system. Few appear to have seriously considered whether their basic premises about China's rise could be wrong. These assumptions should be revisited through a more realistic assessment of whether China, without restructuring its political system, can ever gain the institutional competence required to generate power and prosperity on a sustainable basis. As Beijing changes its leadership, the world needs to reexamine its long-cherished views about China, for they may be rooted in little more than wishful thinking"[9]

The American Bondholders Foundation respectfully requests the Commission to ensure full and fair disclosure by Chinese corporate and government issuers of the financial risks posed by governmental and political instability within China this so that American investors may make fully informed decisions whether to purchase the equity or debt securities of such issuers. Because many of the Chinese corporate issuers subject to the Commission's jurisdiction are majority owned, directly or indirectly, by the very Chinese government whose stability is at risk, a conflict of

[8] Id. The U.S. – China Review Commission estimated that Chinese entities have raised more than $40 billion in international equity markets since 1992, including $14 billion in U.S. markets since 1998. An additional $20 billion in U.S dollar denominated bonds have been sold by Chinese issuers in international offerings since 1992.

[9] "China's Governance Crisis", September/October 2002 Foreign Affairs, Minxin Pei

interest may inhibit management of the corporate issuers from making full disclosure of the potential adverse consequences in the absence of a specific Commission mandate. Accordingly, a specific disclosure mandate by the Commission is warranted in order to ensure protection of American investors. Such mandated disclosure would be similar to other recent Commission initiatives to ensure that issuers provide timely and adequate information about the potentially adverse consequences associated with such risks as environmental liabilities, derivatives and currency fluctuations, and inadequate internal accounting controls.

3. Risk of Debt Repudiation.

The Commission should adopt a policy that requires all registration statements (and subsequent annual reports) filed with the Commission for debt securities issued by a Chinese issuer, including sovereign debt of the Chinese PRC government, to contain a clear statement that the PRC Government of China has repudiated the sovereign debt obligations of predecessor Chinese governments. Prospective American investors are entitled to be fully informed of the official Chinese government position that the current Chinese government is not bound by the sovereign full faith and credit debt obligations incurred by the established and internationally recognized government of China during the pre World War II period.[10] Such disclosure will alert American investors to the possibility that a future Chinese government might be tempted to seek to invoke the precedent of its PRC predecessor by renouncing any obligation to honor Chinese government bonds issued in the 1990's or the first years of the 2000 decade.

The position of the current PRC government of China disclaiming the obligations of an established and widely recognized predecessor government of the same nation is inconsistent with the norms of international law. (See *the Restatement (Third) of the Foreign Relations Law of the United States*, Section 712(2) and Creditors Claims in International Law, The International Lawyer, Vol. 34, page 235, Spring, 2000)[11] In fact, in 1987 China entered into a treaty with Great Britain that recognized the obligation of the current PRC Chinese government for bonds issued prior to the

[10] February 2, 1983 Aide Memoire of the Ministry of Foreign Affairs of the People's Republic of China, included as pages 81-82 of the American Society of International Law, International Legal Materials, 22I.L.M. 75 (1983) wherein the PRC declared "The Chinese Government recognizes no external debts incurred by the defunct Chinese governments and has no obligation to repay them. ...It is a long-established principle of international law that odious debts are not to be succeeded to."

[11] The widely reported assurances of the United States and the international community that financial obligations incurred by the current (Saddam Hussein era) Iraqi government to Russia and to France will be honored by any new Iraqi government following a change of regime is indicative of the prevailing applicability of this principle of international law. As recently as the late 1990's post Soviet era Russia acknowledged its liability to French bondholders for pre-1917 Czarist era Russian sovereign debt.

1949 change of governments.[12] This treaty provided compensation to British holders of Chinese Government bonds issued prior to 1949.[13] American investors are entitled to full disclosure of the repudiations made by the current PRC Chinese government of the sovereign debts of predecessor Chinese governments. Such information is critical to enable prospective American purchasers of Chinese government debt securities to assess the likelihood that a successor Chinese government which might emerge from a political transition to a non-Communist Party dominated state will abide by accepted international law norms and honor debt securities issued by the current PRC government of China. Clearly, as the possibility of political volatility in China becomes increasingly noted by credible analysts,[14] the repudiation by the present Chinese government of a predecessor Chinese government's sovereign debt is a highly material fact that a prudent investor would want to know.

In summary, the American Bondholders Foundation urges the Commission to adopt policies and procedures to ensure the full disclosure to the Commission and the investing American public of the unique and material risks outlined in this letter of investing in Chinese corporate and governmental securities.

Very truly yours,

B. Riney Green

cc: Hon. Paul Atkins
Commissioner

Hon. Roel Campos
Commissioner

Hon. Cynthia A. Glassman
Commissioner

---

[12] According to the New York Times of June 8, 1987, Britain reached a settlement with the Chinese Government. "China was previously barred from issuing bonds on the London market because of its refusal to honor debts incurred by governments before the 1949 Communist Revolution." The settlement did not provide full value to the British bondholders, but it does provide official evidence of the Chinese government's willingness, however reluctantly, to recognize its obligation to honor bonds like those held by American bondholders.

[13] Unfortunately, only British citizens and British companies, and no American bondholders or other non-British nationals, were eligible to submit claims. See Part IV of the Foreign Compensation (People's' Republic of China) Order 1987 of Her Majesty's Government.

[14] See Parts 1 and 2 of this Letter.

Hon. Harvey Goldschmid
Commissioner

Giovanni P. Prezioso, General Counsel

Foreign Bondholders Protective Council

American Bondholders Foundation

10327N:010389:517846:NASHVILLE